

AGENCY PROBLEM IN MICROENTERPRISE  
FINANCING OF BAITUL MAAL WA TAMWIL  
IN INDONESIA

BY

ANDRI MARTIANA

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## ABSTRACT

Poverty is a major economic challenge, and small and medium enterprises (SMEs) play a crucial role in Indonesia's economy, highlighting the potential role of Islamic microfinance institutions (IMFIs) in alleviating poverty in Indonesia. However, IMFIs encounter obstacles, including agency problem, inadequate infrastructure, and unfavorable socioeconomic conditions. Baitul Maal wa Tamwil (BMT), an IMFI in Indonesia, offers unique features and a social development program to enhance its poverty alleviation impact. While there are many studies being conducted on BMT in Indonesia, studies on agency problem specifically related to Sharia-compliance towards achieving operational efficiency in BMT are still lacking and require a thorough comprehension. This study aimed to identify the nature of the agency problem faced by BMT in providing finance to microenterprises in Indonesia, investigate the reasons behind this problem, evaluate BMT's efforts to minimize it, and propose a strategy to overcome this issue in providing finance to microenterprises in Indonesia. This study uses qualitative methods involving 85 participants from active certified Sharia cooperatives, which were part of the oldest BMT established in each province, as well as experts from regulators and academics. Data was collected through interviews, observation, and document analysis. The data was then analyzed using NVivo Qualitative Data Analysis Software (QDAS), and the findings were interpreted. Qualitative reliability techniques were used to assess the reliability of results, with transcripts reviewed to prevent errors and code descriptions, and two independent experts in Islamic microfinance verified the topic's authenticity and obtained feedback. The study reveals agency problem in microenterprise financing at BMT, including adverse selection, ex-ante moral hazard, post-ante moral hazard, and untrustworthy behavior among management staff. The agency problem arises from human Resource (HR) and governance issues, member factors, and inaccurate financing analysis, exacerbated by business conditions that can lead to improper contract selection and BMT's financial stability. BMT addresses these issues through standardizing SOPs, approving staffing and financing SOPs, and regular evaluations. BMT enhances HR capacity through online or offline training, including Sharia finance, bookkeeping, training, and information system facilitation. Despite funding constraints and pandemic conditions, BMT officers conduct member coaching and mentoring activities. BMT is also implementing a strategy to enhance microenterprise financing, focusing on governance, HR capacity, and financial literacy. The plan includes regular staff visits, tightened supervision, recruitment strategies, coaching, mentoring, and training. Special programs and collaborations with universities, Sharia scholars, and policymakers are also being considered. The findings show that BMT's financing performance is negatively impacted by low Islamic financial literacy among staff and poor governance. These findings highlight agency problem in microenterprise financing in BMT, emphasizing the need for regulatory clarity, supervisory structure enhancement, and collaboration between BMT associations and institutions. The significance of research findings can be enhanced through consistent methodologies in different settings or varied methodologies within the same research environment.

## ملخص البحث

يمثل الفقر تحديًا اقتصاديًا كبيرًا، في الوقت الذي تلعب فيه الشركات الصغيرة والمتوسطة دورًا حاسمًا في الاقتصاد الإندونيسي، مما يسלט الضوء على الدور المحتمل لمؤسسات التمويل الأصغر الإسلامية في تخفيف حدة الفقر في إندونيسيا. ومع ذلك، تواجه تلك المؤسسات عقبات تشمل مشاكل الوكالة، وعدم كفاية البنية التحتية، والظروف الاجتماعية والاقتصادية غير المواتية. مؤسسة بيت المال والتمويل، وهي إحدى مؤسسات التمويل الأصغر الإسلامية في إندونيسيا، تقدم ميزات فريدة، وبرنامج تنمية اجتماعية يهدف إلى التخفيف من حدة الفقر. وبالرغم من أن هناك العديد من الدراسات التي تم إجراؤها على مؤسسة بيت المال والتمويل في إندونيسيا، إلا أن الدراسات المتعلقة بمشاكل الوكالة والامتثال للشريعة الإسلامية بغرض تحقيق الكفاءة التشغيلية، لا تزال غير متوفرة، وتتطلب فهمًا شاملاً. تهدف هذه الدراسة إلى التعرف على طبيعة مشكلة الوكالة التي تواجهها بيت المال و التمويل في توفير التمويل للمؤسسات الصغيرة في إندونيسيا، والتحقق في الأسباب وراء هذه المشكلة، و تقييم جهود بيت المال و التمويل للحد منها، و اقتراح استراتيجية للتغلب عليها. تتبني هذه الدراسة نهجًا نوعيًا، وتضم عينة مكونة من (85) مشاركًا يتبعون المؤسسات التعاونية الشرعية المعتمدة النشطة، وقد كانوا جزءًا من أقدم فرع من فروع مؤسسة بيت المال والتمويل التي تأسست في كل محافظة، بالإضافة إلى خبراء من الهيئات التنظيمية والأكاديميين. تم جمع البيانات من خلال الاستبانات، والملاحظة، وتحليل الوثائق. تم تحليل البيانات باستخدام برنامج "أن.فيفو" (NVivo) لتحليل البيانات النوعية، ومن ثم تمت عملية تفسير النتائج. تم استخدام تقنيات الموثوقية النوعية لتقييم موثوقية النتائج، وذلك بالتوازي مع مراجعة النصوص لمنع وقوع الأخطاء، وإجراء عملية الترميز. وقد قام خبيران مستقلان في مجال التمويل الأصغر الإسلامي بالتحقق من صحة الموضوع، وقدمتا التعليقات اللازمة. وقد كشفت الدراسة عن مشاكل الوكالة في تمويل المشاريع الصغرى في مؤسسة بيت المال والتمويل، بما في ذلك الاختيار السلبي، والمخاطر الأخلاقية السابقة، والمخاطر الأخلاقية اللاحقة، والسلوك غير الجدير بالثقة بين موظفي الإدارة. أما مشاكل الوكالة، فتنشأ من قضايا الموارد البشرية، والحوكمة، وعوامل أخرى متعلقة بالأعضاء، وتحليل التمويل غير الدقيق، والتي تتفاقم بسبب ظروف العمل التي يمكن أن تؤدي إلى اختيار غير مناسب للعقود، وإحداث اضطراب في الاستقرار المالي لمؤسسة بيت المال والتمويل. وتقوم مؤسسة بيت المال والتمويل بمعالجة هذه القضايا من خلال توحيد إجراءات التشغيل الموحدة، والموافقة على إجراءات التشغيل الموحدة الخاصة بالتوظيف والتمويل، وإجراء التقييمات المنتظمة. تعمل مؤسسة بيت المال والتمويل على تعزيز قدرة الموارد البشرية من خلال التدريب عبر الإنترنت، أو وجهًا لوجه، بما في ذلك التمويل الشرعي، والمحاسبة، والتدريب، وتسهيل نظم المعلومات. وعلى الرغم من قيود التمويل،

والعقبات التي صاحبت جائحة كورونا، يقوم مسؤولو بيت المال والتمويل بإجراء أنشطة تدريب الأعضاء والإشراف عليهم. كما تقوم مؤسسة بيت المال والتمويل بتنفيذ استراتيجية لتعزيز تمويل المشاريع الصُغرى، مع التركيز على الحوكمة، وتعزيز الموارد البشرية، ومحو الأمية المالية. كما تتضمن الخطة زيارات منتظمة للموظفين، وإشرافاً مشدداً، واتباع إستراتيجيات توظيف محددة، والتدريب، والتوجيه. كما يوضع في عين الاعتبار أهمية عقد البرامج الخاصة، والتعاون مع الجامعات، وعلماء الشريعة، وصانعي السياسات. لقد أظهرت النتائج أن أداء التمويل الذي تقوم به مؤسسة بيت المال والتمويل يتأثر سلباً بانخفاض المعرفة المالية الإسلامية بين الموظفين، وسوء الإدارة. تسلط هذه النتائج الضوء على مشاكل الوكالة في تمويل المشاريع الصُغرى في مؤسسة بيت المال والتمويل، مع التركيز على الحاجة إلى الوضوح التنظيمي، وتعزيز الهيكل الإشرافي، والتعاون بين جمعيات ومؤسسات بيت المال والتمويل. إن نتائج هذه الدراسة يمكن تعزيزها من خلال دراسات مستقبلية ذات منهجيات مختلفة، أو من خلال منهجيات متنوعة داخل بيئة بحثية واحدة.



## **APPROVAL PAGE**

The thesis of Andri Martiana has been approved by the following:

---

Salina Bt. Kassim  
Supervisor

---

Habeebullah Zakariyah  
Co. Supervisor

---

Razali Bin Haron  
Internal Examiner

---

M. Shabri Abd. Majid  
External Examiner

---

Abdulhamid Mohamed Ali Zaroum  
Chairman

## DECLARATION

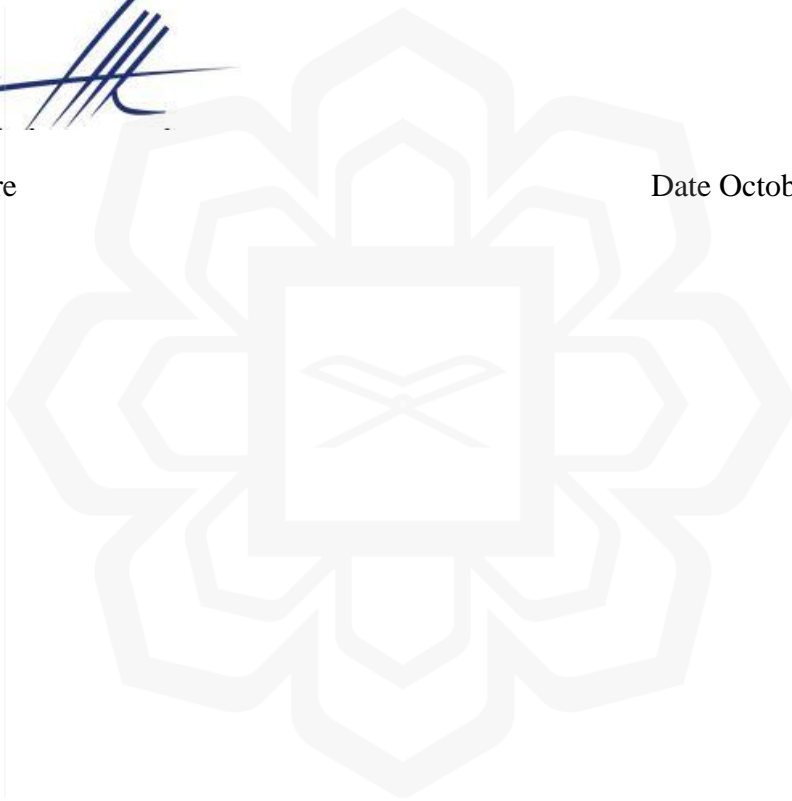
I hereby declare that this thesis is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Andri Martiana



Signature

Date October 23, 2024



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*This thesis is dedicated to my beloved parents, husband, children, other members of my family, and my beloved department Sharia Economics Universitas Muhammadiyah Yogyakarta for all the love, support, and trust that always accompanies my days.*

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## LIST OF ABBREVIATIONS

ABSINDO	Asosiasi BMT Indonesia (The Association of BMT in Indonesia)
AO	Account officer
BBA	Bai' bi tsamani al-ajil
BMT	Baitul Maal wa Tamwil
BOP	Bottom of pyramid
BPR	Bank Perkreditan Rakyat (People's Credit Bank)
BPRS	Bank Pembiayaan Rakyat Syari'ah ((Sharia People's Precredit Bank)
BRI	Bank Rakyat Indonesia
BTM	Baitul Tamwil
BuN	Bait-un-Nasr
CSR	Corporate Social Responsibility
FO	Funding officer
FORKOPI	<i>Forum Koperasi Indonesia</i>
GDP	Gross domestic product
HR	Human resources
IAH	Investment account holders
IFIs	Islamic financial institutions
IMBT	Ijarah muntahia bitamleek
IMFIs	Islamic microfinance institutions
Inkopsyah	<i>Induk Koperasi Syariah</i>
ISHOMA	<i>Istirahat sholat makan</i>
KNEKS	Komite Nasional Ekonomi dan Keuangan Syariah (National Committee for Islamic Economics and Finance)
KSP	Koperasi Simpan Pinjam (Sharia Savings and Loans Cooperative)
KSPPS	Koperasi Simpan Pinjam dan Pembiayaan Syari'ah (Sharia Savings, Loans and Financing Cooperatives)
MFIs	Microfinance institutions
MSMEs	Micro, small, and medium enterprises
NGOs	Non-governmental organizations
OJK	Otoritas Jasa Keuangan (Financial Services Authority)
OIC	Organisation of Islamic Cooperation
OECD	Organisation for Economic Co-operation and Development
PBMT	Perhimpunan BMT Indonesia (Indonesian BMT Association)
PBI	Bank Indonesia regulation
PLS	Profit and loss sharing
PUSKOPSYAH	Pusat Koperasi Syariah (Center of Sharia Cooperative)
QDAS	Qualitative data analysis software
RPIM	Macroprudential inclusive financing ratios
SBA	Small business administration
SBP	State Bank of Pakistan
SDGs	Sustainable development goals
SMEs	Small and medium enterprises
SNI	Standar nasional Indonesia (Indonesian national standard)
SOPs	Standard operational procedures
SPI	Internal control system

UULKM Undang-undang Lembaga Keuangan Mikro (Microfinance institution act)  
USP Unit Simpan Pinjam (Savings and Loans Unit)



# CHAPTER ONE

## INTRODUCTION

### 1.1 BACKGROUND OF THE STUDY

Poverty has become one of the main challenges of economic development, especially for developing countries. If this condition continues, it will have an impact on social problems, such as increasing crime and unemployment, decreasing the quality of human resources (HR), and ultimately hampering economic growth due to low purchasing power (Regina, Sinring, & Arifin, 2020). One solution that can be offered to reduce poverty as explained by Morris, Santos, and Neumeyer (2020) and Olivera and Dejan (2018) is by developing a conducive climate for the growth of small and medium enterprises (SMEs).

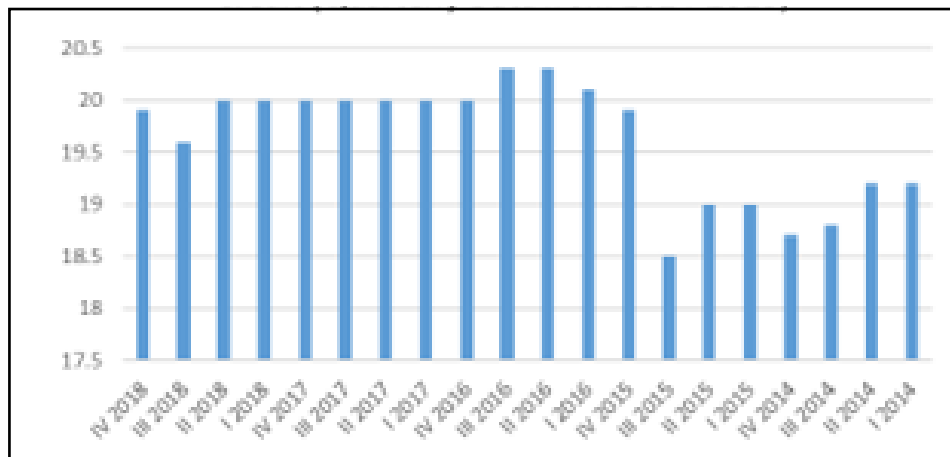
According to Motta (2020) and Đuričin, Jovanović, and Erić (2020), SMEs are regarded as one of the finest platforms for innovation, productivity, and dynamism, supporting various economic sectors through job creation, production development, export orientation, and national revenue growth, particularly in low-income nations. SMEs also can contribute to economic growth and development and become the main drivers of local economic development. However, in many countries, both developed and developing, SMEs encounter barriers to obtaining external funding in the early and middle stages of their entrepreneurial life cycle.

The main reasons for the rejection of most business loan applications for SMEs are the early stage of business establishment and a lack of proper business experience, no collateral, higher transaction costs, poor business planning, small loans, a limited or lower production network, low profits, lower income, cash flow, and poor credit history (Liu, 2017). Furthermore, Liu (2017) also explained that another important reason for the difficulty of financing small and medium enterprises is that capital lenders under asymmetric information will face moral hazards. The issue of asymmetric information is the main problem that causes difficulties in financing small and micro-businesses (Yan, 2018). A more detailed explanation regarding this issue is that lack of funds is

one of the main factors influencing the healthy development of small and microenterprises, and the reason for the tendency for incorrect and asymmetric financial information to occur with financing applications. In this case, if the lender is not aware of it, a moral hazard can occur. To obtain financing, SMEs must have sufficient own capital as collateral. On the other hand, inadequate information, poor counsel, collateral requirements, transaction costs, loan amounts, interest rates, and payment terms, loan maturity, and methods are among the main lender limitations (Thaker et al., 2020; Motta, 2020).

In the Indonesian context, micro, small, and medium enterprises (MSMEs) have an important and strategic role in the structure of the Indonesian economy as well as having high economic resilience (even during the COVID-19 pandemic) to support national economic stability (Bank Indonesia, 2020). This can be seen from the large contribution of MSMEs to the national gross domestic product (GDP), which is 61.1%. In addition, MSMEs are also able to absorb labour by 97.0% and contribute to national exports by 14.4%. The MSME business unit in 2018 made up 99.9% of total businesses. Bank Indonesia's 2022 report shows improvement in banking credit/financing distribution to businesses, supporting economic recovery. Credit growth reached 11.35% in December 2022, with working capital credit growing at 12.17%, and investment credit and consumption credit growing at 12.00% and 9.42%, respectively. Intermediation recovery in Sharia banking also occurred, with financing growth of 20.15%. MSMEs' credit growth reached 10.47%, mainly supported by the micro segment.

Bank Indonesia is also promoting inclusive and green financial policies to strengthen MSMEs' competitiveness as a new source of national economic growth (Bank Indonesia, 2022). Nevertheless, MSMEs in Indonesia still have obstacles, both in obtaining financing and developing their businesses. In terms of financing, there are still many MSME actors who have difficulty getting access to credit from banks or other financial institutions, due to technical constraints, for example not having/not enough collateral, as well as non-technical constraints, such as limited access to banking information. In terms of business development, MSME actors still have limited information on financing patterns for certain commodities. The share of MSME loans to total bank credit in the last five years can be seen in Figure 1.1.



Source: Bank Indonesia, 2018 (processed by the author)

Figure 1.1 The Share of MSMEs Credit to the Total Bank Credit

It can be seen from Figure 1.1 that based on the report on the development of MSMEs in 2014 - 2018 (Bank Indonesia, 2018), the share of MSME loans tends to fluctuate with a very small percentage of no more than 20.3% of total bank credit. As stated in the Bank Indonesia report for the fourth quarter of 2018, the majority of MSME loans were channelled to medium-sized business loans, which was 44.5%, while the percentage of microenterprises was the smallest at 25.4% of total loans. From these data, increasing access to finance, especially for microenterprises in Indonesia, still needs to be improved.

The data shows a disparity in loan distribution among MSMEs, with medium-sized businesses receiving more loans than microenterprises. This small and fluctuating share of loans relative to total bank credit indicates challenges for MSMEs, particularly microenterprises, in accessing finance. The need for improvement is emphasized to increase financial access, particularly for microenterprises, to ensure more balanced and inclusive financial support across all types of MSMEs in Indonesia. Enhancing financial access for microenterprises is essential for their growth and sustainability, as they play a critical role in the economy.

According to the most recent statistics on MSMEs financing from Bank Indonesia, 2022, Islamic banking financing for MSMEs has expanded steadily in line with the national economic recovery process. MSME financing increased 8.98 percent

year on year to Rp75.07 trillion in October 2021, owing to various policies for distributing financing to MSMEs affected by the COVID-19 pandemic as a form of Sharia banking commitment to support MSMEs, which is also part of the implementation of Islamic economic values. However, the proportion of financing to MSMEs remains below the 20% target, which has led to the issuing of Bank Indonesia Regulation (PBI) No.23/13/PBI/2021 on macroprudential inclusive financing ratios (RPIM) for conventional commercial banks, Islamic commercial banks, and Sharia business units which goes into effect on August 31, 2021, will gradually force banks to meet RPIM commitments of up to 30% by 2024.

On the other hand, the poor, because they do not have adequate physical assets, are considered 'unbankable' and unworthy of credit. Therefore, through community, peer monitoring, and mutual accountability, they can choose to have social security, increased rates of return, decreased adverse choices, and decreased rates of bad loans which will ultimately have a positive impact on financing for the poor from default on loans (Thaker, 2020) which are not usually served by conventional financial institutions (Yunus in Taiwo, Yewande, Edwin, & Benson, 2016).

Along with the development of microfinance institutions (MFIs), currently, Islamic microfinance institutions (IMFIs) are growing as alternative organizations with their own approach, namely raising funds to help those in need (Wulandari & Pramesti, 2021). IMFIs, like other MFIs, aim to provide financial services on a micro scale to help poor communities left behind by commercial banks (Handayani, Haniffa, & Hudaib, 2018). Apart from that, the formation of IMFIs was intended to meet the need for Sharia financial services as well as one of the big agendas for the revival of Muslims who were destroyed by colonialism in the nineteenth century (Handayani et al., 2018). This institution is run based on the principles and rules of Islamic law or Sharia where in its operational activities there must be no elements of usury, fraud, ambiguity and gambling (Kakembo & Salleh, 2021). Sources of funds for IMFIs can come from members such as cooperatives, profit sharing from financing customers and other Sharia social financial facilities such as zakat, infaq, sadaqah, and waqf. The financing models that are popularly used at IMFI are financing with musharakah, mudarabah, and murabahah contracts (Kakembo & Salleh, 2021). This institution is usually adopted in Islamic countries because it rejects conventional practices which contain many

prohibited elements and is considered a solution for conventional microfinance partners. Not only that, but conventional microfinance also only pays attention to sustainability and profitability. If linked to the SDGs concept issued by the United Nations in 2015 which is to be achieved by 2030, through Sharia microfinance, several SDGs can be achieved, especially to fight poverty, improve health and education services, increase the availability of clean water and sanitation, and reduce gender inequality in many poor Muslim countries (Mohamed & Fauziyyah, 2020). Therefore, Sharia microfinance will be an impactful step through various innovative products and instruments in achieving the SDGs.

In Indonesia, as explained by Handayani et al. (2018) the development of IMFIs cannot be separated from the socio-economic and political situation, one of which was influenced by financial reform and the Islamic revival movement during 1980-1990. Furthermore, Handayani et al. (2018) classify the development of IMFIs in four periods, namely: the period under Dutch colonialism as the first form of initiative in providing financial services based on Islamic teachings; the 1980s and 1990s when the IMFIs concept began to reemerge; the period between 1990 and 2000 which marked the rapid growth of the IMFIs and the post-2000 period which brought about the collective mobilization that could be considered the IMFIs movement.

In increasing financial inclusion, Islamic finance allows risk sharing and risk diversification through several instruments. The implication of this in financing is through asset-based financing and equity-based financing as a viable alternative to conventional finance, which mainly relies on interest-based schemes. Asset support and risk sharing are the two most prominent elements of Islamic banking and finance that contribute to social and economic growth through entrepreneurship (Thaker et al., 2020). In addition, the philosophy of Islamic banking and finance prioritizes legal, social, and financial transactions that promote fairness and justice in the public interest. In addition, Islam prioritizes risk sharing methods such as zakat, qardhul hasan, etc., (Iqbal & Mirakhor, 2012). Risk sharing is a core notion in Islamic finance that distinguishes it from other financial systems that focus on risk transfer or profit maximization. This technique encourages equity and fairness among participants, hence generating equity and justice. Zakat and qardhul hasan are two risk-sharing systems central to Islamic finance. Zakat is a religious responsibility that entails donating a set

proportion of one's wealth to those in need, redistributing wealth throughout the community, and eliminating socioeconomic disparities. Qardhul hasan is a benevolent loan with no expectation of repayment, embodying Islamic ideals of compassion and social welfare. These risk-sharing systems are tied to the wider Islamic finance ideology, which seeks fairness and justice. The academic basis of Iqbal and Mirakhor (2012) backs up these statements, proving that Islamic financial principles are strongly founded in supporting equitable and reasonable economic practices.

From an empirical review, Ahmad, Lensink, and Mueller (2020) found that although conventional MFIs achieve stronger financial results, the reach of IMFIs exceeds that of conventional MFIs. Demand for Sharia microfinance products and services is still high, but the growth of the Sharia-based microfinance sector is still slow. The main threat in the Islamic microfinance sector is another concern, namely agency problem including information asymmetry, moral hazard, and high transaction costs for collection, tracking, and compliance of small loans (Maouloud, Kassim, & Othman, 2021; Rafay, Farid, Yasser, & Safdar, 2020; Rahmawati & Anuar, 2020). In Islamic microfinance, low numerical skills, inadequate infrastructure, and difficulties in tracking funds are assumed to cause agency problem including poor selection, asymmetric information, and moral hazard problems (Arumsari & Rikawati, 2020).

Issues of moral hazard and adverse selection have undermined the implementation of several important contracts by Islam, particularly in financial companies. Mudarabah and musharakah contracts have become the main victims of the gap between theory and practice (Baldwin, Dar & Persley, 2002). In other words, the fundamental challenge faced in financing with a profit-sharing system, including mudarabah financing, is the existence of asymmetric information (Jasmin, Moeljadi, Djumahir & Djazuli, 2018). According to Warliana and Abdullah (2021), when a company divides its ownership structure and management structure, agency problem will arise. In addition, information inequality between agents and principals causes agency dilemmas in Islamic financial products (Ardiansyah, 2014). On the other hand, Islamic financial contracts, such as Mudarabah, are subject to severe Sharia compliance requirements, which might limit the financing choices available, making it difficult for them to achieve their full potential when compared to conventional financial products.

Adverse selection and moral hazard are two types of asymmetric information. Asymmetric information occurs when one party has information that the other party does not have. In this situation, the *mudharib* (agent) gets access to personal information regarding his or her personality traits. However, the principal (*shahibul maal*) does not know personal information due to the characteristics of information and technological reasons, which require a large budget to obtain information, making the role of the *shahibul maal* inefficient. Furthermore, adverse selection is a form of asymmetric information that can arise in the form of hiding information, customer characteristics that are difficult to know, and analysis errors. Meanwhile, moral hazard problems such as violations of ethics and contracts, as well as misuse of financing funds, may arise (Pangestu, 2018).

According to some experts, adverse selection happens when entrepreneurs acquire pre-contractual information about their company's productivity and financial state, which might alter risk perception and perhaps lead to adverse selection concerns (Muhammad, 2010; Adnan & Muhammad, 2007). In a *mudarabah* contract, for example, the moral hazard problem refers to private information about the business carried out by the *mudharib* that is not recognized by the *shahibul maal*, and the level of utility required by the *mudharib* in the *mudarabah* financing contract is a problem that arises when the *mudharib* uses financing that received as promised. In this case, the "moral hazard problem" arises when *mudharibs* have private information about business operations that the *shahibul maal* (investor) lacks, leading to potential issues where the *mudharib* may not use funds effectively or as intended.

If *shahibul maal* uses screening that is limited to adverse selection for *mudharibs*, then agency problem will not occur in *mudarabah* finances (Muhammad, 2010; Adnan & Muhamad, 2007). The consequence of the adverse selection problem is increasing the danger of default, while moral hazard can reduce the quality of financing, thereby reducing consumers of *mudarabah* financing. As a result of these problems, efforts to overcome them can be carried out through screening, verification, monitoring, and application of Islamic ethics. In this regard, Warliana and Abdullah (2021) argue that to overcome agency conflicts in equity-based contracts, several efforts can be made such as using reliable profit sharing and optimising the profit-sharing ratio to determine consumer characteristics (Ardiansyah, 2014). An optimal sharing ratio can exacerbate

the moral hazard problem because customers must be able to run their business with the least amount of work and earn as much money as possible to meet the bank's and customer's expectations. If the profit-sharing system is not ideal, it will arouse bank suspicion, causing the bank to tighten its controls, which has a direct impact on increasing monitoring and verification costs.

Agency problem may also occur in musharakah contracts, although they do not always occur. Judging from the factors that can influence the occurrence of agency problem in musharakah contracts, Efrianto (2019) states that the variable understanding of the contract and management have no effect on the emergence of agency problem. The variable level of profit and risk has a positive effect on the occurrence of agency problem. However, simultaneously, the variables of contract understanding, level of profit and risk, and management variables have a positive effect on the possibility of agency problem occurring.

On the other hand, agency problem can arise in debt-based contracts, such as murabahah contracts, as well as equity-based arrangements. Regarding the performance and risks of murabahah financing, Hasan, Roziq, and Mas'ud (2017) showed that the competence of Sharia account officers has a quite beneficial influence on the performance variable of murabahah financing. Information asymmetry has a strong detrimental impact on murabahah financial performance indicators. Furthermore, the competency of the Sharia Account Officer does not influence the murabahah financing risk variable. The risk variables in murabahah financing are not influenced by information asymmetry, suggesting that these risks are inherent to the financing structure and not altered by issues related to information availability or transparency. This implies that the risk factors remain unchanged regardless of information availability.

MFIs use a community method known as “Social Guarantee” to solve financial intermediation problems such as asymmetric information. The effectiveness of microfinance programs is based in part on social security and community strategies that help MFIs reduce information asymmetries by rewarding group members and using social pressure to repay loans (Rafay et al., 2020; Sangwan, Nayak, & Samanta, 2020). The joint liability lending system has the potential to reduce moral hazard problems for

borrowers. The moral hazard problem stems from the inability of financial organizations to track borrowers efficiently and, as a result, design trustworthy contracts and enforce responsible behaviour (Nugraha, Chariri, & Utomo, 2020). On the other hand, to increase financial inclusion, there are several obstacles faced by the microfinance industry. As explained by Iqbal and Mirakhor (2012), the main challenges are high interest rates, limited funds to increase customer capacity development, fund transfers, large-scale fund mobilization, product design, and the absence of private sector participation.

BMT, a well-known IMFIs in Indonesia and known as Baitul Qirad, is an Indonesian registered semi-formal IMFIs overseen by the Ministry of Cooperatives and SMEs (Saefullah, 2010);(Masyita & Ahmed, 2013). According to Wulandari and Pramesti (2021), BMT was founded in the 1980s and continued in the 1990s as a project to give financial services to the underprivileged. Wulandari and Pramesti (2021) also said that during the 1998 financial crisis, BMT grew significantly as an alternative non-banking entity. BMT had about 3900 branches in Indonesia as of 2010 and based on Financial Service Authority Indonesia, Otoritas Jasa Keuangan (OJK) data (2018), BMT and BTM data registered as IMFIs under OJK supervision were seven out of a total of 186 MFIS (3.8% of the total MFIS) all of which were cooperative legal entities. On the other hand, data on the number of BMT which are cooperative legal entities and are under the supervision of the Ministry of Cooperatives and SMEs (2023) is 3954 with 1080 institutions using the name BMT Sharia Savings, Loans and Financing Cooperatives (KSPPS BMT) and its derivatives (BTM, Baitul Maal wa Tamwil, Baitul Maal wat Tamwil, etc). Meanwhile, the remaining 2874 use the term KSPPS. Of the total KSPPS, 2495 KSPPS have been certified, with 1775 active certificates and 720 expired certificates, while the remaining 1495 KSPPS have not been certified. On the health side of the cooperative<sup>1</sup>, 410 KSPPS have healthy status, 289 KSPPS are quite healthy, and 3551 KSPPS have not been assessed. In terms of KSPPS classification, 90 KSPPS have good quality (B), 340 KSPPS have sufficient quality (CB), 3502 KSPPS have not been classified, and 14 KSPPS have not been assessed. Based on this data, all

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<sup>1</sup> The term "health side" refers to the assessment of cooperative health in Sharia Financial Services Cooperatives and Units in Indonesia, as per the Minister of State for Cooperatives and Small and Medium Enterprises' Regulation Number 35.3/Per/M.KUKM/X/2007. Cooperative health is determined by the cooperative's financial performance, institutional and management aspects, and can be classified as healthy, fairly healthy, less healthy, or unhealthy.

BMTs are cooperative legal entities, and the number is not small. However, in terms of institutional certification, classification and assessment of institutional health, there are still many KSPPS that have not been classified and/or assessed. This shows the need for increased supervision and regulation of BMT as KSPPS.

The Indonesian government by-law number 17 of 2012 legalized BMT under cooperative laws. BMT was shown to be a successful MFI for relieving poverty by providing financial services and access to the poor as an organization with dual roles, namely commercial and social functions (Wulandari, 2019; Wulandari & Kassim, 2016a). Nevertheless, BMT faces many issues in carrying out its operations (Wulandari & Kassim, 2016a) including those related to the screening process, implementation of credit-plus financing, and the problem of default on poor borrowers, which is caused by moral hazard. In the context of BMT, agency problem is found in profit sharing contracts. These problems arise because the character of the customer is difficult to predict, and Hazard's moral behaviour takes the form of using funds that are not in accordance with those contained in the contract due to the BMT's lack of intensive supervision. The approach to dealing with agency difficulties is done by monitoring and offering incentives in the form of BMT constraints, such as time restrictions.

In terms of the screening process, the screening process at BMT can be classified into two namely poor borrowers must submit their collateral as a requirement when applying for funding to BMT or in the case that individual collateral is not available, poor borrowers must combine group loan schemes with shared responsibility. In reality, however, this system with shared accountability may enhance the likelihood of moral hazard when one member is dependent on another (Wulandari & Pramesti, 2021). In this case, BMT must carry out good monitoring to ensure repayment performance which will require high costs. However, to minimize the occurrence of problematic financing, supervision/monitoring is very important for financing the poor (Wulandari & Pramesti, 2021). This is to ensure that borrowers can pay on time and prevent moral hazards. Issues related to the implementation of credit plus financing are another challenge for BMT itself. It is because to realize credit plus financing, BMTs are required to not only provide financing but also build infrastructure development and maintenance and provide regular training plus religious activities to borrowers. On the other hand, the issue of default on borrowers in BMT can be given a solution through the social function of BMT by utilising zakat, infaq, sadaqah, and waqf funds collected at the institution.

## 1.2 PROBLEM STATEMENT

Poverty is a significant economic challenge, particularly in developing nations. To overcome this problem, it is necessary to create an environment that is conducive to the growth of SMEs, one of which is through providing access to financial assistance for business development. Despite this, financial inclusion is still an issue for SMEs, as rejections often stem from early business establishment and lack of proper experience. SMEs require adequate collateral for financing, but investors face limitations such as inadequate information, poor counsel, collateral requirements, transaction costs, loan amounts, interest rates, payment terms, loan maturity, and lending methods.

Islamic microfinance aims to provide financial services on a micro scale to help poor people left behind by commercial banks. This institution is operated based on the principles and rules of Islamic or Sharia law which in its operational activities there should be no elements of usury, fraud, ambiguity, or gambling. If linked to the SDGs concept issued by the United Nations in 2015 to be achieved by 2030, several SDGs can be achieved, especially to combat poverty and improve health care and education.

Islamic financial institutions (IFIs) operate under contracts promoting fairness and justice, with main rules including usury (*riba*), uncertain risk (*gharar*), and gambling, which intersect with Islamic law in all contracts (Shamsuddin & Ismail, 2013). The agency problem in IFIs is distinct from conventional corporations due to their Sharia-compliant operations and contracts with investment accountholders, which allow managers to extract personal benefits at the expense of Investment Account Holders (IAH) (Safieddine, 2009). While these organizations follow Sharia-compliant standards, which should theoretically assure ethical activities, there is still a possibility that administrators would use these values for personal advantage. This exploitation is done at the expense of IAH, who may suffer financial losses because of the managers' self-serving behavior. Essentially, notwithstanding Sharia law's ethical foundation, the agency problem exists and can emerge in ways that harm investors' interests.

On the other hand, profit and loss sharing (PLS) contracts in Islamic banking face risks like enterprise failure, adverse selection, moral hazard, and costly state verification, which are common issues in both interest-based finance and PLS (El-Komi

& Croson, 2013). IMFIs differ from conventional MFIs in terms of financing, social development programs, and default resolution. They adopt an innovative operational format, focusing on Islamic principles and values. In addition, Microfinance institutions use a group lending strategy called "Social Collateral" to lend to low-income businesses without collateral (Rafay, Farid, Yasser, & Safdar, 2018). This method reduces credit risk and improves loan performance by using shared liability. Group members act as guarantors, gathering soft information from social media to monitor repayment. This method helps MFIs mitigate moral hazard issues and strategic loan default. Social collateral replaces physical collateral, motivating group members and leveraging social pressure in loan payback. Group-based microlending acts as social collateral, reducing asymmetric information in financial intermediation. This approach is particularly beneficial for the poor without physical collateral (Ahmed, 2002), as it eliminates agency problem like asymmetric information from IMFIS, preventing adverse selection and moral hazard. However, in some cases, there are still some asymmetric information issues. Asymmetric information occurs when one party possesses information that the other does not have. Adverse selection and moral hazard are two types of asymmetric information. In a mudarabah contract, for example, the moral hazard problem refers to private information on the effort made by the mudarib that is not observed by the shahibul maal. The shahibul maal's incapacity to directly supervise mudarib's work in managing investments might result in a misalignment of interests, causing the mudarib to make less wise judgments or exert less effort than necessary. This lack of openness may cause mudaribs to work less hard than they would if they shared the risk of financial loss.

Agency problem can arise from BMT as an institution that has not completely exploited management, as well as moral standards, financial factors, and technical difficulties (Sa'diyah & Huda, 2018). Project screening, mudarib screening, compliance with shahibul maal and mudarib on Sharia norms are effective problem-solving solutions for agency problem in mudarabah contracts. The optimal share ratio might exacerbate the moral hazard problem because the borrower should be able to run his business with the least amount of work and make the most money to meet the financial institutions and the customer's expectations.

Agency problem can also arise in debt-based contracts, such as murabahah contracts, as well as equity-based arrangements. Aminudin (2020) shows that Sharia account officers' competency has a considerable beneficial influence on the performance variable of murabahah financing. On the other hand, asymmetric information has a strong detrimental impact on the murabahah finance performance indicator.

Equity funding with a PLS contract effectively addresses the agency problem by aligning the interests of managers and investors. Both parties share earnings and losses, which encourages managers to act in ways that benefit the investment. This alignment reduces conflicts of interest and moral hazard since managers' own financial results are closely related to the venture's performance (Chong & Liu, 2009). Even so, PLS contracts also can raise moral hazard concerns from underreporting benefits (Mohamed & Hassanudin, 2016; Fianto, Gan, Hu, & Roudaki, 2018). Through supervising and monitoring the activities and the beneficiary accounts, this reporting issue can be expected. However, in developing countries, many other barriers emerge, namely in terms of insufficient physical infrastructure, socio-economic conditions of clients, and official IMFIS issues that can further increase the cost of supervision/monitoring and increase adverse selection and moral hazard issues.

To finance the poor who are unable to provide collateral for the proposed funding and can reduce the incidence of asymmetric details, group lending with a joint liability scheme can be applied (Alaro & Alalubosa, 2019). In another empirical study, it was also found that peer monitoring can solve the problem of moral hazard in lending to people who do not have large enough collateral (Carpenter & Williams, 2012). However, in certain cases in its implementation, the joint liability scheme requires the easing of the terms in the contract. In addition, theoretically, one of the implications of easing contract terms is a decrease in payment performance. If the original contract terms were optimally designed to control issues such as moral hazard, strategic default, and screening, then easing these requirements would lead to an increased incidence of borrower default (Tassel, 2000).

On the other hand, Armendáriz and Morduch (2010) argued that direct supervision, non-financial risks, and regular repayment schedules lead to better

repayment performance in MFIs even in the absence of contracts for physical collateral and joint liability. Chaudhary and Ishfaq (2003) state that conventional forms of collateral have proven to be unimportant in determining the likelihood of loan repayment. So, the need is to evaluate creditworthiness from the perspective of the borrower according to their proposed investment. In cases where no collateral can be offered, social security can be offered so that the allocation of loans does not depend on the distribution of wealth. In addition, Diagne (2000) demonstrated that the attached importance of access to a future loan is the key factor driving high repayment performance in group lending. This group lending scheme also has a negative aspect, which is if the borrowers do not know each other. Conflicts often occur in and/or between group members where BMT monitoring is required.

BMT is one of the popular faith-based microfinance models in the Indonesian context, which has become an important alternative microfinance program comparable to its conventional counterpart. BMT was shown to be a successful MFI for relieving poverty by providing financial services and access to the poor as an organization with dual roles, namely commercial and social functions. Nevertheless, BMT faces many issues in carrying out its operations, including those related to the screening process, implementation of credit-plus financing, and the problem of default on poor borrowers, which is caused by moral hazard. To enhance the role of this institution in alleviating poverty, the unique aspect of BMT as a business and social entity with special characteristics such as the social development program as part of credit-plus financing features will mitigate the risk of different problems due to asymmetric information (Wulandari & Kassim, 2016; Abdullah, Shamsuddin, & Mahmood, 2019).

In the case of BMT in Indonesia, many researchers have discussed the experience, challenge, role, and performance of Islamic microfinance (Adnan & Muhamad, 2007; Aminudin, 2020; Basuki, 2013; Efrianto, 2019; Effendi, 2017; Febianto, Johari, & Zulkefli, 2019; Husaeni & Dew, 2019; Jasmin et al., 2018; Nazirwan, 2015; Riwijanti, 2014; Sa'diyah & Huda, 2018; Wulandari, 2019; Wulandari & Kassim, 2016; Wulandari, Kassim, Sulung, & Putri, 2016). Nevertheless, empirical evidence that focuses on agency problem including asymmetric information and moral hazard issues faced in microenterprise financing through this institution is still lacking. Because of this issue of Sharia-compliance with BMT operational efficiency, a

complex, thorough understanding of the issues is needed. It is felt that there seems to be a literary gap in this case of study. Thus, this empirical study aims to discover the agency problem in microenterprise financing of BMT in Indonesia. At this point in the study, the agency issues will be generally identified as the case at the operational level, which usually involves adverse selection and moral hazard issues such as misappropriation of funds, presenting collateral belonging to other individuals, undetected bad characters, and the sale of products purchased with financing funds (Riwajanti, 2014) in the context of microenterprise financing of BMT in Indonesia. These issues indicate potential problems such as misappropriation of funds or lack of proper management and oversight in product utilization and sales.

### **1.3 PURPOSE OF THE STUDY**

The main goal of this research is to investigate the agency problem faced by BMT in providing finance to microenterprises in Indonesia and provide a solution to mitigate that issue.

### **1.4 RESEARCH OBJECTIVES**

The study aimed to achieve the following objectives:

1. To identify the nature of agency problem faced by BMT in providing finance to microenterprises in Indonesia.
2. To investigate the reasons why agency problem still occurs in BMT in providing finance for microenterprises in Indonesia.
3. To evaluate efforts implemented by BMT to minimize the agency problem faced by BMT in providing finance to microenterprises in Indonesia.
4. To propose a strategy on how to overcome agency problem faced by BMT in providing finance to microenterprises in Indonesia.

## **1.5 RESEARCH QUESTIONS**

In addition to and in line with the research aim and objectives, the following research questions are addressed in this study:

1. What is the nature of agency problem faced by BMT in providing finance to microenterprises in Indonesia?
2. Why does agency problem still occur in BMT in providing finance for microenterprises in Indonesia?
3. To what extent do the efforts undertaken by Indonesia's BMTs minimize the agency problem in the microenterprise financing that they provide?
4. How can strategies proposed help to overcome the agency problem faced by BMT in providing finance to microenterprises in Indonesia?

## **1.6 SIGNIFICANCE OF THE STUDY**

The global gap in financing for MSMEs is substantial since entrepreneurs require a range of financial services including deposits, payments, loans, equity, and guarantees. The objective of this research is to accomplish part of the 17 SDGs, which encompass the elimination of poverty, the advancement of economic growth, increased productivity, and the promotion of technical innovation. Although there was a significant reduction of 50% in extreme poverty from 1990 to 2015, a considerable number of individuals continue to have challenges in meeting their fundamental human requirements. Promoting entrepreneurs could help and foster job growth, while also eliminating forced labour, slavery, and human trafficking, which are essential for attaining comprehensive and fruitful employment opportunities and satisfactory work conditions for both men and women by the year 2030. Indonesia is also focusing on improving credit access to MSMEs in the second and fifth agendas of the G20 Indonesia presidency, which aims to promote global synergy and economic recovery. This

includes expanding economic and financial inclusion for MSMEs, women, and youth. The country is also accelerating the financial sector and real sector transformation.

In the context of accessing finance to the poor, Indonesia, Bangladesh, and Sudan are the top three nations in the world in terms of microfinance products and services (Rahmawati, Annuar, & Siraj, 2020). As a developing country with a Muslim majority population, Indonesia can create the ideal Islamic microfinance model by mobilising money not just for the poor but also for the poorest in the informal economy. However, in Indonesia, Islamic microfinance has issues and obstacles linked to agency relationships, namely asymmetric information that might generate moral hazard. As a result, research that focuses on the issue of moral hazard and the constraints of funding microenterprises through BMTs might be useful.

BMT is one of the popular Islamic MFIs in Indonesia which manages social funds from zakat, infaq, and sadaqah, as well as a commercial function by collecting and distributing funds to partners or customers. BMT, also known as a cooperative, is one of the oldest organizations designed to enhance financial inclusion in developing countries. In the Indonesian case, it has significant governance weaknesses, but it can provide an effective approach to address these issues. This institution has certain unique abilities, such as reaching remote rural areas, mobilising local resources through savings, and supporting beneficiaries in the self-help dynamic. The risks associated with information asymmetry, as well as the high transaction costs associated with processing, monitoring, and enforcing small loans, are the primary concerns in financial intermediation. The provision of suitable and accessible financial inclusion information would stimulate the community's entrepreneurial spirit and enhance production and welfare in rural areas.

Various Sharia financing products may be able to satisfy societal expectations, particularly in Muslim-majority countries such as Indonesia. Murabahah contracts are the most prevalent, in which the lender provides physical goods that the borrower purchases in instalments. This contract has been criticized for imposing an implicit interest rate and failing to consider the profit-sharing incentive. Mudarabah and musharakah contracts are alternative contracts that eliminate riba and adhere to the profit-sharing concept. Because borrowers have a larger incentive to disclose low

returns, these profit-based contracts entail more severe moral hazard issues. Cross-reporting has the potential to decrease moral hazard concerns in peer-monitored lending, particularly in profit-sharing arrangements.

BMT has offered a variety of solutions to the problem of large collateral from low-income community borrowers. Among these include character screening, collateral as a formality, and a family-based collateral strategy. Cases of collateral fraud were resolved by undertaking extensive background checks and screening. Lower-income borrowers should be subject to fewer collateral requirements. Collateral insurance is provided to compensate for the lack of collateral insurance. Risks connected with asymmetric information between borrowers and lenders threaten IFIs such as BMTs. Because accessibility reduced the likelihood of loan allocation, BMTs had to decrease their collateral requirements for lower-income applicants. Group lending schemes allow lower-income individuals to participate without individual assurances or collateral, ensuring security and increasing access to financial resources. The group's collective duty acts as collateral, reducing the risk involved with lending to individuals who do not have conventional types of collateral.

There is a significant limited literature on Islamic microfinance, particularly on agency problem and its concerns. This study is anticipated to improve understanding of the agency problem of microenterprise funding in Indonesian BMTs. Most prior research, particularly in Indonesia, has focused on the role of MFIs in poverty reduction. The current study attempts to fill the gap by identifying the agency problem of BMT in providing financing to microenterprises in Indonesia, assessing the role of the institution's program, and then offering remedies. The author also investigates programs that constitute one of the distinguishing features of BMT, specifically Islamic social development initiatives that are thought to have an impact on partners' financial literacy.

## **1.7 LIMITATIONS OF THE STUDY**

In consideration of the difficulties of finding data on the issue, the restricted allocation of funds, and time constraints, this study focuses on the agency problem in the microenterprise financing of BMT in Indonesia. The definition of microenterprises here

refers to the definition according to the context in Indonesia, namely under Law no. 20/2008 which states that microenterprises are small companies owned and managed by a person or owned by a small group of people with a maximum amount of assets (excluding land and buildings of business premises) of IDR 50 million and a maximum turnover of IDR 300 million or around IDR 1,000,000 per day (assuming active operational for 300 days/year) (UKM Indonesia, 2019).

This study is confined to profit-sharing financing (*mudarabah*, *musharakah*) and the most common financing product offered by BMTs, *murabahah* (Riwajanti, 2014), which is expected to have agency issues in its application of the contract, *ijarah*, and *qardhul hasan*. Furthermore, as Rahman (2010) mentions, these mentioned contracts have the potential to be expanded and implemented as Islamic microfinance schemes. *Mudarabah* has the potential to be adapted as an Islamic microfinance scheme in which the capital provider or MFIs (*rabbul mal*) and the small entrepreneur (*mudarib*) become partners and the profits from the project are shared between the capital provider and the entrepreneur, but the capital provider bears the entire financial loss. This is because a *mudarib* invests *mudarabah* funds on a trust basis, thus it is not responsible for losses unless in situations of misbehaviour. *Musharakah* can be created as a microfinance plan in which MFIs collaborate with micro-entrepreneurs. If there is a profit, it will be divided according to the pre-agreed-upon ratio, and if there is a loss, it will be divided according to the capital contribution ratio. *Murabahah* is a microfinance method that requires MFIs to acquire and purchase assets or business equipment before selling them to entrepreneurs at a profit. They also offer instalment payment programs and guarantee ownership until final payment is made.

## **1.8 ORGANIZATION OF THE THESIS**

The structure of this thesis consists of seven chapters which include the first chapter, namely the introduction which explains the background of the research which is then narrowed down to the problem formulation and continues with the main purpose of the research, objectives, research questions, significance of the research which are reflected in the importance of the research, then proceed to the limitations of research and the organization of writing a thesis. The second chapter is a literature review, namely an

analysis of the content of the research review based on the research themes raised. The third chapter contains the theoretical and frameworks related to the research theme, empirical evidence, and followed by the identification of the research gap. Chapter four details the research methodology, while Chapter five provides a comprehensive description of the research object, results, and findings. Interpretation of research results are discussed in chapter six, and finally, chapter seven will explain the highlights of the major findings of the research and its implications, recommendations, limitations, and suggestions for future research.



## **CHAPTER TWO**

### **ISLAMIC MICROFINANCE AND MICROENTERPRISE FINANCING**

#### **2.1 INTRODUCTION**

A literature review is a thorough analysis of prior research on a specific topic (Denney & Tewksbury, 2013) which becomes an essential feature of any academic project (Webster & Watson, 2002). It aids in theory development, identifies gaps in existing research, and identifies areas for further research projects (Webster & Watson, 2002). It aids in qualitative studies by selecting research phenomena, framing philosophical underpinnings, and guiding data analysis and interpretation (Wu & Volker, 2009). A literature review can provide an informative, critical, and useful synthesis of a subject, identifying known and unknown aspects, highlighting areas of controversy, and formulating questions for further research (Bolderston, 2008). This chapter will discuss relevant literature reviews related to the research theme.

#### **2.2 ISLAMIC MICROFINANCE**

##### **2.2.1 Definition of Islamic Microfinance**

Microfinance, introduced by Grameen Bank in the 1970s to aid Bangladeshis, has grown significantly and is now a global tool for supporting small enterprises and poverty reduction. Initially provided by non-governmental organizations (NGOs), it has attracted various providers, including commercial banks, insurance companies, and telecommunications companies, with some focusing on social impact and fiscal performance (Hurlburt, 2012). Microfinance offers financial services to individuals with limited banking access, including financing, savings, remittances, and insurance, as defined by Karlan and Golberg (Nugroho, 2015). Microfinance is the provision of financial services and products to individuals with low economic status who are excluded from conventional financial institutions or programs (Azamia & Thaker, 2020). Microfinance is a program that provides small loans to impoverished individuals for

self-employment projects, generating income to support themselves and their families (Alkhan & Hassan, 2021).

The literature suggests that the terms "microfinance" and "poverty" are closely linked, with much literature including both terms within their titles, suggesting that the primary philosophy behind microfinance is to address poverty, both internationally and locally (Alkhan & Hassan, 2021). Microfinance organizations in Bangladesh for instance, are actively working towards achieving SDGs through various investment modes, including poverty reduction, food endangerment, health education, clean drinking water, sanitation, gender equality, and funding (Uddin, 2020). These initiatives contribute to financial development, environmental sustainability, and social inclusion, creating work opportunities and distributing knowledge. According to Ginanjar and Kassim (2020), microfinance empowers the poor by enabling them to start and maintain businesses, with green microfinance combining it with environmental awareness. It uses simple procedures, and collateral abolishment, and maintains relationships to provide financial assistance, aid in financial and personal issues, and promote environmental awareness. Microfinance size varies based on local circumstances, with loans in Bosnia and Herzegovina or Kosovo being around 1,000 euros, while in lower-income countries like Sudan or Pakistan, it is relatively large (Khan, 2008). In the Indonesian context, Law no. 1 of 2013 defines a microfinance institution as a financial institution serving the community on a micro-scale, providing services like business development, savings management, and community empowerment through loans or financing. MFIs can be cooperatives or limited liability companies, and their business activities can be conventional or based on Sharia principles, as long as they don't conflict with statutory provisions (As-Salafiyah & Kartikawati, 2022).

Ahmad, Lensink, and Mueller (2020) asserted that conventional MFIs promote financial inclusion but raise ethical concerns about commercialization and high interest rates. Islamic MFIs, which adhere to Sharia's prohibition of *riba*, offer an alternative. A global survey of 543 conventional and 101 Islamic MFIs conducted by Ahmad et al., (2020) found that the market for Islamic microfinance is more important than previously recognized and is likely to grow globally. Statistical comparisons show that IMFIs have a wider reach and depth than conventional MFIs, but conventional MFIs achieve stronger financial performance.

According to Alkhan and Hassan (2021), Islamic finance operates under Sharia principles, which are derived from the Holy Qur'an, Sunnah, Ijma', and Qiyas. Other sources include istihsan, 'urf, and istislah or masalih al mursalah. Each ruling in Sharia has a deeper meaning, known as maqasid al-shari'a, which protects and preserves their deen, nafs, 'aql, nasl, and mal. In accordance with the Islamic finance concept, specifically, El-Komi and Croson (2013) explained that Islamic microfinance is based on four principles from Sharia, including the prohibition of interest, risk-sharing, time-value of money, and gharar. The prohibition of interest allows for administrative expenses and inflation compensation, while risk-sharing involves lenders sharing profits and losses and turning fund providers become shareholders. Islamic finance, unlike traditional finance, uses profit-sharing mechanisms like mudarabah or musharakah to compensate for the time value of money. This approach adheres to Sharia restrictions while upholding the time value of money idea. Fund suppliers are treated like investors, sharing earnings and losses rather than collecting interest. This method follows Islamic teachings while preserving the idea of money's temporal worth. The restriction of riba corresponds to the temporal worth of money, whereas gharar prohibits excessive risks and speculative conduct.

Dusuki's study (2008) emphasized the importance of microfinance in Islamic banks, highlighting the system's role in promoting poverty alleviation, social justice, and equal distribution of wealth. It suggests that Islamic banks should focus on the social and economic ends of financial transactions, incorporating Sharia principles and innovative approaches like social intermediation and group-based lending programs. This approach can be implemented without compromising institutional viability, competitiveness, and sustainability. Islamic microfinance is an emerging industry in Muslim countries like Indonesia, Malaysia, Pakistan, Bangladesh, and MENA, aiming to eradicate poverty and improve social standards by adhering to Sharia rulings (Azmia & Thaker, 2020). Another assertion by Mansori, Kim, and Safari (2015) stated that Islamic microfinance is a growing industry in Muslim countries like Bangladesh, Nigeria, and Malaysia, addressing the role of financial intermediaries in Sharia. Major Sharia-compliant contract specifics such as mudarabah, musharakah, murabahah, ijarah, and qardhul hasan can be used as an underlying model, offering benefits or restrictions for microfinance parties.

Islamic microfinance is a social and financial instrument that boosts MSMEs' productivity and contributes to a country's economic development. IMFIs are like MFIs but apply Sharia principles to their products, contracts, and operations. IMFIs, a Sharia-based financial institution, aims to balance material and spiritual purposes for the pleasure of Allah SWT (Wediawati, Effendi, Herwany, & Masyita, 2018). It operates dual missions, providing financial and social intermediation and a spiritual mission. Its spiritual intermediary activity educates and propagates Sharia principles, ensuring comprehensive understanding and practice by all stakeholders. The role of the spiritual intermediary involves balancing the spiritual aspects of Islamic teachings with the operational aspects of financial services, ensuring all actions and policies reflect Islamic values and principles, and avoiding impractical concepts. The research conducted by Muhammad (2020) in one of the IMFIs in Indonesia reveals that Islamic microfinance institutions successfully implemented i-CSR due to a mutual passion for conventional CSR typologies. This convergence involved managerial behaviour, creating sustainable corporate values, and focusing on economic, legal, ethical, and philanthropic responsibilities. Islamic values enriched the implementation, making it worthy of worship and a divergent element from conventional CSR concepts.

IMFIs in Indonesia are divided into two types: bank IMFIs and non-bank IMFIs. Bank IMFIs operate as banks and adhere to Islamic banking principles, prohibiting interest on loans and requiring transactions to comply with Sharia law. Non-bank IMFIs, on the other hand, operate under Sharia principles but do not function as banks. They have a legal framework and operational system to ensure their practices align with Islamic finance rules (As-Salafiyah & Kartikawati, 2022). BMT is a non-bank microfinance institution that combines *maal* (collection and distribution of social funds) and *tamwil* (collection and distribution of commercial funds) in one institution. It implements a profit-sharing system, promoting dignity and protecting the interests of the poor, with initial capital from local community leaders (As-Salafiyah & Kartikawati, 2022). Islamic microfinance is a Sharia-compliant financial service for the poor and needy in predominantly Muslim countries. It is crucial for poverty eradication and economic growth, as it is free from interest and uses Islamic contracts like profit and loss sharing. It charges low interest rates, making it a credible alternative for hardcore poor populations (Nawai, 2020).

### **2.2.2 Principles of Islamic Microfinance Financing**

The Grameen Bank is one example of a successful microfinance organization. It was founded by Muhammad Yunus, the 2006 Nobel Prize in Economics recipient, who also succeeded in bringing microfinance to the attention of the global population. The Grameen Bank, on the other hand, is not a Sharia-compliant financial institution since it collects interest on loans and pays interest to depositors. The practice of using basic interest calculations (rather than compounded interest calculations) does not alleviate or mitigate the issue of riba. Whether the interest is simple or compounded, it is still considered generating money from money, which is prohibited in Islamic finance.

The availability of microfinance alternatives to exploitative lending is welcomed, but its long-term viability is questioned if it opposes the values and beliefs of local Muslim communities. Simply spreading materialism and consumerism into rural and shantytown regions may erode social cohesion by establishing unmet expectations, leading to long-term dissatisfaction and discontent or economic crime. Financing through debt financing, equity financing through mudarabah and savings programs, and money transfers such as zakat and Sadaqat should all be included in comprehensive Islamic microfinance.

Several key ideas in Sharia apply to money and commercial transactions that distinguish Islamic finance from conventional finance (Khan & Phillips, 2010). El-Komi & Croson (2012) presented four ideas taken from Sharia (Islamic jurisprudence) regulations that are recognized by most experts as the cornerstone of contemporary Islamic banking in this context. The Arabic word "riba" is often rendered as "usury" rather than "interest." Riba does not apply to usury, which is the modern-day practice of charging unfair interest rates. Riba is also thought to be an uneven funding mechanism that takes advantage of others' "misfortunes" and enhances the proclivity for money to amass in the hands of the few. The riba prohibition includes provisions for financial intermediaries' operational costs as well as inflation compensation. It does not make money just through lending money (a piece of money cannot get another piece, according to Aristotle). The second idea is risk-sharing, which indicates that lenders share in the profits and losses of the firm. This demands an ex-post evaluation of earnings for these companies, which is not necessary for an interest-based loan. By

prohibiting riba, Islamic finance shifts funds obtained from passive borrowers (earning fixed interest) to active investors (sharing in the investment's profits and losses). This trend is consistent with the Islamic concept of risk-sharing, ensuring that financial transactions are fairer and more tied to real economic activity.

Money is only a means of trade if it is not invested in productive activity, according to Sharia law. Riba prohibition is based on the notion that interest is fixed and earned regardless of whether the productive function to which it is assigned is effective. This gives it a distinct edge, even though the financial impact (profit or loss) of spending money is uncertain. The fourth principle is the limitation of Gharar. Gharar, like riba, is an Arabic word that has no analogue in English. It simply means that someone is taking excessive risks and participating in speculative activity, such as gambling. The quantity, nature, recoverability, or longevity of an exchange contract must be ambiguous in Gharar. Academics argue that insurance contracts can convert inherent ambiguity into controlled risk, allowing for structured risk management rather than leaving it ambiguous, suggesting that proper insurance can effectively manage risk. Selling what one does not own is prohibited, and financial responsibility must be borne only by the lenders of money, not by the manager or agents who handle the funds (Khan & Phillips, 2010). Only socially useful activities that are neither exploitative nor socially or ethically harmful should be funded, and transactions should be based on genuine economic activity rather than financial speculation and needless ambiguity. All parties must be able to see what they are buying or selling.

### **2.2.3 Islamic Microfinance Instruments**

To adapt Islamic finance ideas to modern banking, several financial products have been devised (El-Komi & Croson, 2012; Khan & Phillips, 2010). A variety of financing techniques are available, depending on the type of the product or firm and the length of the project's funding. Mudarabah and other profit-sharing financing models, such as qardhul hasan and murabahah, need greater engagement from program personnel and may be riskier. As a result, it is uncommon for a microfinance institution to manage more than a restricted number of clients at any given time. Herein lies the conundrum: should financial sustainability take precedence over significant development and

outreach? It is envisaged that it will foster the supply of Islamic-financing-compliant microfinance services and, eventually, the usage of these services by microentrepreneurs. Mudarabah and other profit-sharing financing schemes, such as qardhul hasan and murabahah, need more participation from program staff and may be riskier. As a result, a microfinance institution is unlikely to manage more than a limited number of clients at any given moment. The question is whether financial sustainability should take precedence over major development and outreach.

Successful Islamic microfinance programs are more difficult to develop and administer than interest-based programs, but they are more practical and offer various extra benefits. They tend to create higher rates of economic growth, according to Islamic Relief's experience; anecdotal evidence suggests that microentrepreneurs are willing to embark on more profitable ventures provided risk is shared (Khan, 2008). PLS will almost certainly result in more efficient and better resource allocation.

Some contracts have a lot of potential for advancement and adaptation as Islamic microfinance schemes (Rahman, 2010), as explained below:

**a) Mudarabah**

Profit-sharing agreements, or "mudarabah," are one of the PLS's most well-known financial structures. According to the terms of this agreement, the financial agent shall give cash to the entrepreneur for investment in an economic activity in exchange for a predetermined part of the benefit. If the project is profitable, the profit will be divided as agreed. Mudarabah, involves two parties: the lender and the entrepreneur. Profits are divided on a predetermined basis between financiers and businesses. If a failure occurs in the usual course of business and not because of the entrepreneur's carelessness or fraud, the financier will lose all his or her income. Mudarabah can be adopted as an Islamic microfinance method. The project's profits are divided between the financing source and the entrepreneur. The supplier of funds will bear the whole financial loss. The Mudarabah structure can be simple or bilateral, with the microfinance institution providing resources and the microentrepreneur acting as an entrepreneur. Mudarabah structures can also be two-tiered or re-mudarabah structures. After the final settlement,

the entrepreneur will control the firm enterprise. Without intervention from the financier, the entrepreneur will exercise full control over the company. Micro-entrepreneurs do not usually have proper accounts or financial statements (Dhumale & Sapcanin, 1999). Meanwhile, muzara'ah is a type of mudarabah contract in agriculture where the microfinance institution can provide lending or money capital for the agricultural product in return for a share of the harvest. In the sense of microfinance, the capital provider may need large quantities of capital and expertise to manage such an initiative. In addition, the MFIs may face capital impairment risk as the loss of micro entrepreneurs' operations exposes it to the risk of capital erosion (Mirakhor & Iqbal, 1999). Rabbul mal responsibilities is confined to its capital contribution and nothing more. Their responsibility is limited to the amount they invested, guaranteeing that their financial exposure does not exceed the original investment. This is critical for controlling risks and addressing moral hazard concerns inside the partnership. Mudarib is required to act with the utmost integrity, otherwise he is deemed to have done so. This has significant consequences for the issue of moral hazard (Iqbal, 2006). Furthermore, Iqbal (2006) explained that no benefit transfer can take place (except as an ad hoc agreement and subject to final settlement) until all liabilities have been resolved and rabbul mal equity restored. The manager is also permitted to combine the capital of the mudarabah with his own funds. In this case, the benefit may be allocated in accordance with any ratio decided between the two parties, but the loss shall be borne in proportion to the owner of the capital.

#### **b) Musharakah**

The second famous PLS contract includes participation in equity (musharakah). Musharakah is a classic joint venture. The contract is a combination of partnership and mudarabah (El-Komi & Croson, 2012). Musharakah means partnership in Arabic which both parties supply capital and share in the management of the financed undertaking (Khan & Phillips, 2010). The musharakah contract is similar to mudarabah, with the exception that both partners are interested in the management and provision of resources (Iqbal, 2006). Profits are divided between each partner based on the ratio of his or her contribution. Musharakah can also be developed as a microfinance service (Rahman, 2010). Microfinance will enter a relationship with micro-entrepreneurs. If there is a

benefit, it will be shared based on the pre-agreed ratio. Capital is not permanent in musharakah mutanaqisah. Any repayment of capital by an entrepreneur would reduce the overall capital ratio of the provider of capital. The repayment period depends on the pre-agreed period. Musaqat, a partnership profit and loss sharing contract for orchards, is another type of musharakah. In this situation, all musharakah capital could also be subject to capital impairment risk if the capital cannot be recovered as it is lower than the debt instruments on liquidation (Haron & Hock, 2007). Standard risk reduction strategies that can be implemented by a third-party guarantee.

### **c) Murabahah**

In the classic fiqh literature, there is a sales contract called bay' mu'ajjal, which applies to the selling of products or property against deferred payment. Islamic banks are now using this contract as a form of finance in the following manner (Iqbal, 2006). The client orders the Islamic Bank to buy a certain product for him at a particular cash price then this client promises to buy those items from the bank after they have been ordered, but at a deferred price, which involves a negotiated profit margin called a mark-up in favour of the bank. The deferred price can be charged as a lump sum or in instalments. In practice, this sale takes the form of bay al-murabahah, which stands for the supply of products by the seller to the purchaser. Murabahah is a markup trade (or a cost-plus selling contract) used for the purchase of goods and other credit items which is generally used for short-term funding purposes. The contract has been criticized due to its similarities to an interest loan and the lack of understanding among Islamic scholars and weak Muslims, who may be less rigorous in distinguishing between Islamic laws and conventional interest-based transactions, leading to confusion or acceptance of the similarities (El-Komi & Croson, 2012). Murabahah includes the resale of a product after the investor applies a special profit margin. Usually, the payment is made in instalments to the financial person who pays the price to the original supplier of the products (Khan & Phillips, 2010). This form of finance is widely used for the financing of properties or inputs of working capital, such as raw materials, machinery, or equipment. Using murabahah, the IMFIs buy business equipment and sells it to an entrepreneur at a markup. Repayments of the sale price will be paid on an instalment basis. This scheme is the most suitable scheme for the procurement of business equipment. This mode of

financing was introduced in Yemen in 1997 and has more than 1,000 active borrowers (Rahman, 2010). In addition, Rahman (2010) stated that this contract is the most realistic and appropriate scheme for Islamic microfinance. This is because it is easier to handle and track the Buy-Resell model which makes payments in equal instalments.

#### **d) Ijarah**

There are other types of Islamic financial instruments which are also commonly used in financial transactions. These contracts are, however, similar to well-known traditional financial contracts (El-Komi & Croson, 2012). Ijarah, for example, is a lending contract that is commonly used for financing cars, machinery, and equipment. Ijarah is similar to leasing which an entrepreneur short of funds is approaching a financier to finance the acquisition of a productive asset (Khan & Phillips, 2010). Financiers can purchase and lease the productive asset to the entrepreneur. Ijarah is, by definition, a long-term rental arrangement according to the conditions laid down by the Sharia (Rahman, 2010). Unlike traditional finance leases, the lessor (microfinance institution) not only owns the asset but is responsible for controlling the usage of the asset. Ijarah Muntahia Bitamleek (IMBT) is an elaborate definition of ijarah in which the transfer of ownership would take place at the end of the contract. IMBT is best adapted to the microfinance system, particularly for micro-entrepreneurs in need of assets or equipment. Microfinance will purchase the assets needed by the contractors and rent the assets to eligible entrepreneurs. Entrepreneurs can only rent the assets over a period and pay rents at regular intervals. As a lessee, the entrepreneur will be responsible for safeguarding the asset, while the lessor will control its use (Haron & Hock, 2007). Operating leases have a variety of characteristics that differentiate them from other types of leasing (Iqbal, 2006). The lessor is the actual owner of the leased asset and assumes all the costs and liabilities of ownership. The lease is not for the entire useful life, but only for a defined short period, unless renewed by mutual consent of both parties. The lessee shall be responsible for day-to-day maintenance and routine repairs.

#### **e) Qardhul Hasan**

The Qur'an specifically encourages Muslims to give qardhul hasan or charitable loans to 'those who need them'. Some Islamic lenders only offer loans to current customers, while others limit such loans to poor or vulnerable individuals (Khan & Phillips, 2010). With such loans, the borrower only needs to repay the principal, although some scholars allow the lender to cover the administrative costs incurred in disbursing the loan. Islam does not lay down unique ways of financing; rather, it sets out certain general concepts that can support it. In Arabic, this means a "beautiful loan" perhaps because, as the Quran says, "these loans are made to Allah rather than to the borrower" (Rahman, 2010). This alleviates the misery of "giving up" a portion of one's possessions by lending them to others in need (Mirakhor & Iqbal, 1999). Rahman (2010) also explained in more depth that the microfinance institution would then only be able to charge a service fee. The payment term will be on an instalment basis for the negotiated duration. The scheme is also applicable to microentrepreneurs who need immediate cash and have a strong opportunity for full settlement.

#### **f) Salam**

In the case of the product is delivered in the future, deferred-delivery selling (bay salam) is comparable to a forward contract (El-Komi & Croson, 2012). This instrument is a sales contract in which the price is paid in advance against the delivery of the goods/services purchased. Even though this contract does not apply to the microfinance industry, Islamic banks may provide funding through a salam contract. For example, the bank could purchase the goods by making an advance payment to the supplier and setting the date of delivery as the date requested by the customer. It can then sell the products to a third party either on a salam basis or on an instalment basis. Sharia rules require that a second contract be different from the first and unrelated to it (Iqbal, 2006). When an Islamic bank executes a second transaction following an original Salam contract, it must be done as a separate contract to prevent disputes or problems and ensure Sharia compliance.

#### **2.2.4 Roles of Islamic Microfinance Institutions in Poverty Alleviation**

Poverty in its most general sense is the lack of necessities. Basic food, shelter, medical care, and safety are generally thought necessary based on shared values of human dignity. However, what is a necessity to one person is not uniformly a necessity to others. Needs may be relative to what is possible and are based on the social definition and experience (Sen, 1999). Valentine (1969) said that "the essence of poverty is inequality." In slightly different words, the basic meaning of poverty is relative deprivation. Poverty is a fundamental problem in economic development, especially in developing countries such as Indonesia. To reduce poverty and income inequality, the government can implement policy strategies that support the welfare of the poor (pro-poor). Various programs or policies for poverty alleviation have been carried out and this is proven by the decline in the number of poor people.

Referring to the Central Statistics Agency 2018, it stated that the percentage of poor people in Indonesia in March 2018 fell by 9.82%. Nevertheless, these programs have not fully resolved the problem of poverty (Central Bank of Indonesia, 2016). One of the policy strategies such as efforts to solve social problems using a diverse approach through capital assistance to support entrepreneurship as an example, have become one of the breakthroughs in several countries. Most of the development policies in developing countries focus on providing assets and access to capital for the poor (Rahman, 2010). It is well documented that for many micro-entrepreneurs, lack of access to financial services is a critical constraint to the establishment or expansion of viable microenterprises (Ardyantara, Sukarna, Sadono, & Arifin, 2020). The few existing conventional MFIs have been greatly criticized for their dubious acts of charging exorbitant interests and other dues to the already poverty-ridden and marginalized people (Kakembo & Ahmad, 2019). One of the capital providers that has the potential to provide access to finance for the poor is microfinance institutions. This institution can affect poverty alleviation and is an effective tool for economic and financial development (Sohn & Ume, 2019).

The roots of microfinance are not only about money but also about helping people achieve dignity, respect and meaning in their lives and escape the trap of poverty (Handayani et al., 2018). Since the success of the Grameen Bank program introduced

by Muhammad Yunus (2006 Nobel Peace Prize laureate) in Bangladesh in the early 1980s, world financial institutions have begun to pay greater attention to microfinance to alleviate poverty, and achieve benefit from it (Baskara, 2013). In addition, the Islamic model of this institution has the potential to develop access to finance levels that are not affordable, especially by other financial institutions such as banks in the Muslim world (World Bank, 2008).

Microcredit as presented by Rokhim et al. (2016) has a positive impact on client welfare; however, the effect is not linear and there may be an optimal frequency of borrowing. In addition, the results also show that age, income level, and deposit level are three important determinants of lending behaviour. Other evidence according to Hassan (2014) shows that when women are involved in income-generating activities, they show greater courage in adventure into experience and prove to be productive. Furthermore, Hassan (2014) stated that increasing women's income and assets plays a very important role in increasing women's economic independence and their self-confidence. This helps in breaking the poverty cycle they live in and allows them to better control their lives and economic decisions.

From a spiritual perspective, Zsolnai and Illes (2017) recognized the superiority of a spiritual, creative, and caring business model that can activate the intrinsic motivation of economic actors to serve the common good and use multidimensional ways to measure success. Another study conducted by Khan & Phillips (2010) mentions the results of a survey of the influence of faith on Islamic microfinance programs showing that most borrowers seek loans for religious reasons. Even further, 38% of borrowers interviewed said that they had chosen to take loans mainly because they were in accordance with their religious beliefs, with more than half of those interviewed, 55% to be exact, stating that the nature of Islam was very important in their decisions. In addition, in a study comparing Christian and secular MFIs, it was found that Christian MFIs have much lower funding costs and consistently perform poorly in terms of financial profit indicators, contrary to the hypothesis, Christian MFIs are equally efficient in guaranteeing loan payments and loan size on average they are equivalent to their secular counterparts (Mersland, D'Espallier, & Supphellen, 2013). In this case Casselman, Sama, and Stefanidis (2015) added that MFIs affiliated with religion were significantly more socially oriented regarding their mission statement, the process of

services provided to their clients (peripheral services in the form of micro credit and insurance), the number of borrowers they serve and the average size of loans they provide.

In addition, it can be seen from an ethical point of view that the supply of Islamic microfinance has grown rapidly, but it still has some way to go to overcome the ethical and economic shortcomings associated with the supply of microfinance (Tisdell & Ahmad, 2018). Another study conducted by Alaro and Alalubosa (2019) exploring Islamic non-interest microfinance options which will guarantee the financial inclusion. Dusuki (2008) also explained that alleviating poverty continuously and overcoming the low level of social and economic development of Muslims around the world is the biggest challenge in facing the global development community when the world has entered the new millennium.

Microfinance requires an innovative approach beyond the role of traditional financial intermediaries. Among other things, building human capacity through social intermediation and designing group-based loan programs has proven to be an effective tool to reduce transaction costs and reduce exposure to various financial risks associated with providing credit to the rural poor. The group-based approach also encourages better information flow between lenders and borrowers and hence lack of adverse selection and moral hazard in the credit market. Islam has the potential to provide various schemes and instruments that can be developed and adapted for the purposes of microfinance (Rahman, 2010). Relatively, the qardhul hasan, murabahah, and ijarah schemes are relatively easy to manage and will guarantee capital requirements (qardhul hasan), equipment (murabahah), and lease quadrants (ijarah) for prospective micro-entrepreneurs and poor people. Participatory schemes such as mudarabah and musharakah, on the other hand, have great potential for microfinance purposes because this scheme can meet the risk sharing needs of micro entrepreneurs. This scheme, however, requires special skills in managing the risks inherent in the contract structure.

For Muslim-majority countries such as Indonesia, microfinance institutions, especially those with Islamic principles, have the potential to become good models for screening funds for the poor because this institution provides a combination of social intermediary institutions and capital providers in which activities are more community

development (Baskara, 2013, Wulandari & Kassim, 2016). Islam has the potential to provide various schemes and instruments that can be developed and adapted for microfinance purposes. Conventional microfinance schemes and interest-based operations (usury) are prohibited in Islam and, therefore, cannot be used by and for Muslims (Elden et al., 2019). Therefore, Rahman (2010) in his article stated that various Islamic financing schemes are based on the concepts of *mudarabah*, *musharakah*, *murabahah*, *ijarah*, etc. It has prominent characteristics that can contribute to more ethical economic and financial development for poor and micro-entrepreneurs.

The goal of Islamic microfinance itself is to target the poorest people working in the informal economy (Hasaan, 2014). Regarding this, Mahmood, Hussain, and Matlay (2014) stated that loans from microfinance facilitate increased family income and education of children of women entrepreneurs in Pakistan and have an impact on the socio-economic development of low-income households, especially women those who cannot access financial services due to their poverty. IMFIs products such as Bai' Bi Tsamani Al-Ajil (BBA) and *mudarabah* products to empower poor people in various productive businesses have been able to reduce the level and severity of poverty among its customers (Adnan & Ajija, 2015). Related to product implementation, Haneef, Pramanik, Mohammed, Amin, & Muhammad (2015) said that on the side of poverty alleviation, is possible through the integration of the *waqf*-Islam microfinance model.

In addition, Haneef et al. (2015) also urge that borrowers receive education and training programmes. Educational activities, when appropriately integrated with financial services, may empower customers by assisting them in developing the entrepreneurial knowledge and business skills required for everyday living activities. This method meets everyone's learning requirements while also empowering underprivileged customers to run a viable business and, most crucially, repay their debts (Hadi, Wahyudin, Ardiwinata, & Abdu, 2015). Additionally, according to Abbas and Shirazi (2015), many Islamic bankers strongly believe that Islamic microfinance improves the financial situation of the underprivileged. Furthermore, middle- and upper-level management concur that Islamic microfinance has a lot of potential to serve low-income individuals or those who refuse interest-based financing in addition to existing programmes. They do, however, agree wholeheartedly that Islamic microfinance is necessary, particularly to support the less fortunate segments of society.

Furthermore, the literature review states that Islamic microfinance has emerged as an important instrument for reducing poverty and enhancing the social and economic well-being of its beneficiaries, and it has been applied in Bangladesh, Egypt, Indonesia, Iran, Nigeria, Pakistan, Türkiye, and Yemen (Hassan, 2014). Abbas and Shirazi (2015) discovered that the respondents' strong beliefs support Islamic microfinance through a PLS scheme. On the other hand, most customers believe that Islamic banks do not support micro-business owners with lesser incomes. This study also found that the lack of skills, experience and professionalism among support staff is one of the limitations of Islamic microfinance. Despite this, Islamic bankers have shown a strong consensus that Islamic banks must provide Islamic microfinance instruments and products to meet the needs of underprivileged communities to reduce poverty.

Hassan (2014) conducted a study that examined the current state of Islamic banks in Pakistan, their operations, and the obstacles facing Islamic microfinance. The study drew on the perspectives of Islamic bankers, regulators, micro-entrepreneurs, and petty traders, who are the main participants in the credit market. This study discovered that group action via Islamic microfinance organisations contributes to members' economic improvement, environmental awareness, and successful LCR management. It is also discovered in another study that the Mumbai, India-based Bait-un-Nasr (BuN) Urban Cooperative Credit Society, has been effective in offering interest-free microfinance services in India. A few operational problems have been identified, and suggested fixes are offered. However, it is discovered that BuN's performance has been worse than the industry norms for microfinance. According to Sobana and Husaeni (2019), Islamic microfinance that follows the Grameen Bank model helps impoverished women become more economically empowered. The secret to successfully uplifting the impoverished is social and financial wealth. Poverty reduction and Islamic microfinance using the Grameen model are closely related, however, Kasim and Rahman (2018) noted instances of default risks in microlending. Sobana and Husaeni (2019) study highlights the following factors that contribute to microfinance defaults: unskilled field workers, post-disbursement monitoring, technical support, weekly payments, accessible databases, illness in a family member, concealing a company, a lack of drive, and excessively stretched financial obligations. Because 80 percent of microfinance funding receivers are women without formal education, the results of these cases show that post-disbursement supervision is crucial to the success of microfinance.

Research on the impact of Islamic microfinance on clients' well-being has been done by several academics. Usman, Tasmin, and Ulum (2019) studied a sample of 291 respondents (employees of Amanah Ikhtiar Malaysia in the east-coast states of Malaysia) to investigate the mediating role of entrepreneurial empowerment in the link between Islamic microfinance and the well-being of clients. This study demonstrated the favourable association between entrepreneurial empowerment and Islamic financing using structural equation modelling. Despite the study's assertion that Islamic microfinance services have no positive impact on the well-being of their consumers, a novel discovery revealed how entrepreneurial empowerment functions as the fundamental component of Islamic microfinance's success.

The subsequent research was carried out at Tijarah Microfinance Bank in Bauchi, Nigeria, by Ibrahim and Murtala (2018). This study examined the management's and the client's perspectives on the institution's contribution to reducing poverty. Purposive sampling was used to choose respondents from among the 80 clients and 11 employees of Tijarah Microfinance Bank in Bauchi, who were asked to complete a standardised questionnaire. Using the purposive sample approach, the 80 clients and 11 employees of Tijarah Microfinance Bank, Bauchi, answered structured questionnaires to become respondents. The results indicate that while the respondents generally agreed that Islamic microfinance banks could reduce poverty in Bauchi State, there was a notable difference in how the two categories of respondents perceived these banks' ability to do so.

Microfinance providers and their consumers must develop by internalising Islamic spiritual ideals inside the IMFIs. One strategy that aids in staff and customer development is value-based education and training. IMFIs should be able to help reduce poverty and offer chances for the social, spiritual, and economic advancement of the local community as well as the larger society by offering financial products and making investments in fostering human development (Khalid & Kamaruddin, 2019). Due to Indonesian society's extreme heterogeneity, financial institutions must reflect the unique traits of each group. The communal nature of Indonesians makes them an excellent fit for the kind of financial organisations that comprise community banks (Baskara, 2013). According to Baskara (2013), MFIs have originated in Indonesia and expanded from urban to rural regions at the behest of the public, commercial, and non-

governmental sectors in both their official and informal capacities. However, several problems with institutions, rules, and institutional governance, as well as how well this institution performs its function in economic growth, pose a threat to its long-term viability (Baskara, 2013)<sup>2</sup>. The role of BMT, in alleviating poverty is explained by additional research which also revealed an interesting trend that after receiving financing from BMT, members' incomes climbed dramatically.

### **2.2.5 Islamic Microfinance Institutions in Indonesia**

According to Akbar and Siti-Nabiha (2022), IFIs aim to provide financing and services in line with Sharia principles, including spirituality and da'wah. Their objectives include disseminating information, raising awareness about Islamic financial principles, and paying zakat and charitable contributions. IFIs balance commercial and social goals, considering spiritual value, marketing, and client relationships. Social benefits are derived from zakat and donation funds. Specifically, MFIs are financial institutions that can improve household welfare, reduce poverty, and create financial inclusion for the poor. They can be flexible and adapt to local needs, such as non-governmental organizations, rural banks, village banks, and cooperatives. This access to finance is crucial for the poor, with economic and social impacts including better education, health, and housing. MFIs in Bangladesh for instance offer various delivery models including Self Help Groups, Individual Banking Programs, Grameen Model, and Mixed Model (Alam, Nizam, & Hidayat, 2021). Islamic microfinance is a new economic development strategy in Indonesia that aims to help low-income individuals access financial goods and services. It plays a crucial role in community empowerment and poverty alleviation. Indonesia's economy heavily relies on microfinance, with MSMEs accounting for over 90% of the workforce and 60.34% of GDP (Nabbila & Sulistyowati, 2023). To address economic issues, IMFIs offer solution financing products through website portals and office displays, with BMT acting as an intermediary for transactions. Indonesia is focusing on inclusive finance in the fintech era to enhance Islamic banking quality and empower unbanked communities. As one of the largest digital economies in 2024, the government is working to empower all Indonesians,

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<sup>2</sup> The latest data from the Financial Services Authority states that microfinance institutions are officially registered totaling 186, of which 35 are Sharia Microfinance Institutions.

especially those in remote areas, to benefit from technological developments in financial finances. Fintech, closely related to the Internet, supports financial inclusion programs by enabling fast, easy, cheap, and efficient transactions without face-to-face meetings or branchless banking (Sadari & Hakim, 2019)

In Indonesia, IFIs, known as Sharia financial institutions, are responsible for withdrawing and distributing money to the public. In the microscope of IFIs, there are various types of microfinance worldwide, including project-based microfinance funded by donors, non-profit organizations (NGOs) with no legal framework, and cooperatives which offer savings and credit services to members which offer savings and credit services to members (Fianto, Gan, Hu, & Roudaki, 2018). IMFIs, particularly in Indonesia, have experienced rapid growth in the past three decades and high continuity in meeting customer needs (Bahagia & Ridwan, 2022), operating based on Islamic principles and adhering to Sharia compliance standards, prohibiting interest charges (Fianto, Gan, & Hu, 2019). IMFIs in Indonesia, such as BMT, Cooperatives Sharia, and Sharia People's Precredit Bank (*BPRS*) (Bahagia & Ridwan, 2022), are crucial for the Indonesian economy, providing financing for small businesses, particularly those from low-income communities, and are expected to help alleviate poverty in the country (Siskawati, Hendri, & Gustiawati, 2015). These institutions have grown rapidly and offer equity financing with profit and loss-sharing mechanisms and debt-based financing products. IMFIs provide financial access, particularly savings and credit, to low-income families and rural areas and play a significant role in addressing rural poverty alleviation (Bahagia & Ridwan, 2022; Fianto et al., 2018). These individuals earn income from renting land, vehicles, animals, machinery, and equipment in small quantities.

The Sharia-based pattern began in 2003 with 26 KSP/USP-Sharia Cooperatives and increased to 100 KSP/USP Sharia cooperatives in 2004. The objectives of Sharia cooperatives are to improve the welfare of members and society, contributing to a just economic order in accordance with Islamic principles. Sharia People's Credit Bank (*BPRS*) is a bank financial institution that accepts savings and channels funds using Sharia principles. The establishment of People's Credit Bank (*BPR*) is influenced by founding financial institutions like Village Bank, Village Lumbung, Pasar Bank, Bank Employees of Lumbung Select Nagari, Village Credit Institution, Credit Bank Village,

District Credit Bank, Small People's Business Credit, District Credit Institution, Village Production Bank, and others (Bahagia & Ridwan, 2022). Sharia financial institutions, unlike conventional banks, are socially focused and adhere to principles of justice and equality. Trust in these institutions is based on experience and Islamic values, such as "*likay laa yakuuna duulatan bainal aghniyaa-i minkum*" (preventing wealth circulation among the rich). They can develop financing for underprivileged small businesses, organize small to medium business groups, and provide soft financing assistance. They can also act as small entrepreneurial partners, providing light capital assistance, coaching, and empowerment at the grassroots level (Bahagia & Ridwan, 2022).

BMT is an IMFIs that collects and distributes non-profit funds like zakat, infaq, and sadaqah. It operates through two activities: Bait al Maal and Bait at Tamwil. In Bait al Maal, BMT accepts zakat, infaq, and sadakah and distributes them according to its regulations. In Bait at Tamwil, BMT focuses on developing productive businesses, improving small business activities, encouraging savings, and supporting economic activities. The organization offers grants and revolving loans without a fee for repayment, providing funds for urgent living needs, medical assistance, school fees, and disaster donations. BMT also functions as a Sharia financial institution, collecting and distributing funds based on Sharia principles. The objectives of BMT within the Islamic economic system include enhancing poverty eradication, promoting welfare, providing financing, encouraging frugal behaviour, developing productive businesses, increasing awareness about Islamic economic systems, aiding weak entrepreneurs, and serving as an alternative financial institution for accelerated national economy growth (Bahagia & Ridwan, 2022).

Another assertion states that Sharia microfinance in Indonesia, also known as BMT, is an integrated independent business centre that focuses on business development, investment in increasing productive businesses and supporting small entrepreneurs' economic activities. BMT combines their products with charity-based funds raised from zakah and sadaqat, distributing funds to the poorest (Fianto et al., 2018) according to regulations and mandates (Bahagia & Ridwan, 2022). The study conducted by Fianto et al. (2018) reveals that IMFIs significantly improve rural households' welfare, particularly in terms of income. Indonesia, the world's largest Muslim country, has the potential to benefit from these institutions. However, most

clients require collateral, suggesting they do not target the poorest. The study also suggested Islamic MFIs as an alternative for providing financial access to poor Muslims worldwide. In addition, according to Bahagia and Ridwan (2022), Indonesia's MSMEs which become most customers or members of IMFIs, have struggled to access capital due to the dominance of conglomerates in conventional banks, leading to speculative ventures and the collapse of the private sector in 1997-1999. The government has adopted a policy to disburse aid funds, BLBI liquidity, which differs from IFIs like BMT, which provide financing to the real sector in MSMEs. In accordance with Akbar and Siti-Nabiha (2022) statement, there is no clear operationalization mechanism for what constitutes *maslahah*. Stakeholders suggest including social well-being in performance measures, requiring BPRS for instance to develop client-based measures to assess the impact of financing on clients' well-being. Therefore, IFIs need to develop a more holistic assessment of their performance. Empowering the MSME sector benefits the state ideology, democracy, and resilience in facing financial crises. Empowering the real sector will increase economic production and distribution, allowing for equal enjoyment. Sharia financial institutions play a crucial role in providing accessible financial institutions for small business actors, collecting community savings, and channelling them internally as loans or capital. However, this profit-sharing system does not allow borrowing for non-business needs, such as school tuition fees or Eid purchases.

Another research also asserts that Indonesia's IMFIs are experiencing slow growth compared to conventional counterparts, influenced by factors like ease of service, speed, proximity, method, and loan officers' profile. A survey of 581 MFI borrowers conducted by Masyita and Ahmed (2011) revealed that most clients prefer Islamic MFIs based on low interest rates and loan size. Conventional MFI, BRI, is the most competitive, followed by BPRS, BPR, and BMT. The survey also highlighted gaps in IMFIs' role in reducing unemployment and poverty. To boost demand, economic and non-economic factors should be brought to the level of conventional MFIs. The study conducted by Wediawati, Effendi, Herwany and Masyita (2018) on 98 units of BMTs in Indonesia highlights the impact of financial, social, and spiritual intermediation on the sustainability of IMFIs in Indonesia. To address sustainability issues, IMFI should adopt a holistic approach aligning with horizontal and vertical goals, focusing on Sharia principles, and balancing worldly objectives with the purpose of the hereafter.

Based on Rusydiana and Devi's (2013) study, IMFIs in Indonesia aim to improve the welfare of members and society. Despite its rapid growth, it faces internal and external obstacles. Prioritising technical aspects, legal/structure, market/communal, and HR aspects, the organization prioritizes coaching/socialization/mentoring, product innovation, strategic location, collaboration with other IFIs, and external elements such as information centres. Strategic priorities include optimising government funding, coordinating with PINBUK, and linking program between IMFIs, BMT, BPRS, and Sharia Commercial Bank program. The community service project, Sharia Financial Literacy Assistance for a KSPPS BMT in Indonesia, conducted by Latifah and Suroso (2023) revealed that existing Sharia contracts are limited to products and financing, and the application of financial reports is not yet available. Additionally, human resources are not fully understood, highlighting the need for continuous assistance in Sharia financial inclusion.

## **2.3 MICROENTERPRISE FINANCING**

### **2.3.1 Definition of Microenterprise**

In both developed and developing countries, SMEs are recognized as having an important contribution to the economic development of a country. Through their role in industrial development in a country, SMEs have a positive effect on job creation and poverty alleviation. Experience around the world proves the special role and importance of SMEs in the national economy. This type of business is predicted to be the main vector of economic progress, both in developed countries and in transition countries (Savlovski, 2011). The precise definition of SMEs remains elusive (Klute-Wenig & Refflinghaus, 2020), this is due to conceptualization challenges, especially because of the thin dividing line between companies and different interpretations from one country to another or from one industry to another (Abdullahi, 2018).

Meanwhile, SMEs are understood as groups of businesses that are neither too small nor too large (Cambridge Dictionary, 2021). Madani (2018) explained the different criteria for defining SMEs in several countries in the world. For example, the OECD defines SMEs simply by looking at the number of employees in each of these companies. Microenterprises are businesses with less than 10 employees, small

businesses are businesses with 10 to <50 workers, while the number of workers in medium-sized businesses is 50 to 250 employees. This definition is different from the European Commission and the World Bank which include turnover and balance sheets in differentiating the three businesses. Furthermore, Madani (2018) also described the definition of SMEs in the United States, China, Canada, and Japan, all of which have sectoral definitions for SMEs. More specifically, they do not only use parameters that are often used, namely the number of employees, turnover, and balance sheet. In the United States, there is no standard definition that applies to all SMEs.

The Small Business Administration (SBA) oversees the definition of SMEs, which considers a variety of factors including ownership structure, revenue, and workforce size in addition to one crucial factor: the industry in which the business operates. There is no common definition for SMEs in Canada either, with several organisations offering their definitions. One definition that has been proposed adds the company's business sector as a primary criterion. In Japan, the definition of SMEs is determined by the capital value and workforce size in addition to the industry. Different definitions of SMEs have been provided by several Pakistani official organisations, including The SME Bank, SMEDA, Pakistan Bureau of Statistics (PBS), and State Bank of Pakistan (SBP) (Dar, Ahmed, & Raziq, 2017). SMEDA, for instance, uses the total amount of productive assets and staff count to define SMEs. The sole criterion used by SME Bank is asset amount. PBS solely takes staff count into account. In the meanwhile, the SBP defines SMEs based on the kind of firm, number of workers, capital employed, and annual net sales dollar amount. Dar et al. (2017) added that these different definitions are separate issues in Pakistan related to the formulation and monitoring of SMEs. This is because a credible definition will serve as a functional key to enable policymakers to set benchmarks to measure progressive improvement in SME standards and work.

However, when Grameen Bank's successful microcredit programmes helped the rural poor in Bangladesh manage their family-run businesses in the late 1970s, the idea of microenterprise gained traction in both academics and practice (Thapa, 2015). Small-scale firms are frequently the category in which microenterprises fall. It does, however, vary from other firms in a few strange ways. In the 1980s, Nappi & Vora (1980) found that state-by-state variations existed in the definition of small businesses. They

proposed the need for a national set of basic criteria, such as annual income or the number of employees, to establish standards by which government agencies could recognise small businesses. According to Munoz (2010), a microenterprise is a very small commercial entity that has existed from the beginning of economic evolution. Fundamentally, it is entrepreneurship, based on tried-and-true methods that work in real life. According to the word "microenterprise" describes tiny companies (Howells, 2000) that are owned and run by impoverished individuals or groups of individuals with the assistance of supporting organisations. Multiple people can own or run microenterprises, and frequently, these people's families are also engaged. Alternatively, a group of people might jointly own and run them. Micro-businesses engage in a broad range of small-scale manufacturing, sales, and service operations. It is critical to understand that micro companies are, by definition, those that were founded with technical support from an outside sponsoring organisation and that they need to be separated from more typical small-scale businesses that do not receive this support. A firm or collection of enterprises that typically employ less than five people is referred to as a microenterprise (Cambridge Dictionary, 2021). Midgley (2008) stated that tiny firms are referred to as "microenterprises."

Microenterprise also has varied definitions across countries and organizations (Thapa, 2015). with company size varying based on regions and countries (Inan, Gungor, Bititci, & Halim-Lim, 2022), suggesting a lack of universally agreed definitions and instead providing contextual meanings (Zhang & Ayele, 2022). According to Anastasia (2015), for example, in the USA context, a microenterprise is a small business that is defined as having fewer than ten employees and being economically disadvantaged, which means that the business is low income or very low income and does not have access to capital or other resources that are necessary for business success (U.S. Small Business Administration 15 U.S. Code 6901 Definitions). In contrast to small and medium-sized businesses, micro firms are not formally defined in the framework of Bangladesh. According to Tareq & Rahman (2020), a microenterprise is an economic unit that has the following characteristics. "It is owned and managed by one person and started by her/himself or inherited; engaged in trading, manufacturing or service rendering activities; often engages family members in its operations; employs 0-5 employees; has the investment of not more than Tk. 3,00,000 including fixed assets; works usually in the informal sector and requires little or no

government interventions; acts as the channel through which the relatively unprivileged vulnerable sections of the community can generate and diversify their incomes to remove their impoverishments and improve their standards of living and it ultimately contributes to the overall socio-economic development of the society.” In Malaysia, microenterprises are defined as firms in manufacturing or agriculture-based industries that retain annual revenue of less than RM250,000 (\$76,4531) or employ fewer than five full-time workers or those in other sectors with annual revenue below RM200,000 According to Mohiuddin, Mazumder, Al Mamun and Su, 2020), microenterprises in Malaysia are defined as businesses in the manufacturing or agricultural sectors with fewer than five full-time employees or annual revenue of less than RM250,000 (\$76,4531) or those in other sectors with annual revenue of less than RM200,000 (\$61,162) or that employ fewer than five people. Within the framework of Nepal, a microenterprise is characterised as an enterprise that employs up to nine people, including the entrepreneur, who has less than NRs. 200,000 in fixed investment (excluding houses and land) and involves the entrepreneur in management. 2,000,000 yearly financial transactions, requires no licence or authorization to operate and consumes less than 10 kilowatts of power or energy (Nepal's Industrial Policy in Thapa, 2015). According to studies conducted in Ethiopia, the paid-up capital of small and microenterprises—small enterprises having a capital of less than or equal to Birr 500,000, and microenterprises having a capital of less than or equal to Birr 20,000—determines their strategy and policy documents (Zhang & Ayele, 2022).

SME participation in the economy is substantial in Indonesia. Many company metrics, including the number of business units, employees, and investment, demonstrate interdependence (Cahyadin, 2017). The Republic of Indonesia Law No. 20 in 2008 on MSMEs defines microenterprises as profitable businesses with a maximum net worth of IDR 20,000,000 that are held by individuals or by groups of people (apart from properties and structures used as commercial spaces). It is necessary to have annual sales of no more than IDR 300,000,000 and IDR 50,000,000. A small business has annual revenues between Rp 300,000,000 and Rp 2,500,000,000 and a net worth between Rp 50,000,000 and Rp 500,000,000. A company classified as medium-sized with yearly sales of more than Rp. 2,500,000,000–Rp. 50,000,000,000 and a net value of more than Rp. 500,000,000–Rp. 10,000,000,000. Although supported by the existence of legality based on the law, MSMEs in Indonesia still face challenges and

problems, especially in terms of competition in the global realm. Evalina (2018) identified these, namely a) improving the quality of HR; b) strengthening legal aspects c) protection of trademarks and copyrights; d) funding support and marketing assistance e) price stabilization and guarantee of raw price availability; and e) standard tax costs for MSMEs.

### **2.3.2 Issues and Challenges of Microenterprises**

Microenterprise development faces limitations due to qualitative positive implications, slow progress, and in-country factors like poor literacy, limited infrastructure, and government policies that discourage the poorest from entering the formal economy (Fairley, 1998). These factors undermine the impact of microenterprises and decrease donor confidence, hindering their impact on people's lives. According to Akamobi (2020), small-scale enterprises often face challenges due to factors such as lack of support, managerial and operational problems, inexperience, technical knowledge, poor managerial skills, poor planning, and market research. Other factors include poor bookkeeping practices, environmental challenges, unfriendly business environment, government regulations, and competition. Other issues include lack of HR, development skills, access to finance, macroeconomic policies, modern technology, infrastructure, market access, obsolete equipment, corruption, poor infrastructure, and lack of support services. Furthermore, Akamobi's (2020) survey in Sub-Saharan African countries revealed that the primary obstacle to microenterprise development is a lack of capital, electricity, access roads, and land. Microentrepreneurs often operate in makeshift offices, rented apartments, or under tree shade, often receiving half of their earnings as rent. Most microentrepreneurs complain of lack of government assistance and inconsistency in policies, which negatively impact their development. They claim they only hear about incentives on radio, television, or newspapers, but often fail to access them.

Monahan, Shah, and Mattare (2011) identified twelve possible factors for the future growth of micro-business entrepreneurs in Maryland, America and found that a strong national economy was the dominant issue perceived by micro-business entrepreneurs. The other factors are the ability to penetrate new markets, a well-trained

workforce, the use of the Internet, mergers, outsourcing, and exporting. On the other hand, Monahan et al. (2011) explained that the largest factor perceived as a challenge to micro-business future growth was the economy by far. The other factors are distance, taxes, state and federal regulations, healthcare costs, finding qualified employees, labour costs, capital, and balancing work, and family life. According to Prasad and Tata (2009), microenterprises face unique barriers, rely on network structures and utilize social capital to overcome difficulties in accessing capital, distribution channels, business support, and markets.

According to Abebe and Gemed (2020), major infrastructural challenges, marketing challenges, managerial challenges, and financial challenges hinder the growth of SMEs. Major challenges include power interruptions, poor transportation, inadequate market, lack of trained manpower, poor working culture, and poor follow-up opportunities include expanding the education sector, technological advancement, reducing unemployment, and transforming population trends. According to Maksum, Sri Rahayu, and Kusumawardhani (2020), microenterprises have several challenges, such as inadequate funding, expertise, and technology, which results in low competitiveness. Based on Lekha and Thiagarajan's (2022) study, microenterprise in India faces financial, managerial, market-related, legal, and political challenges, particularly for women entrepreneurs from low-income households due to gender and societal pressures. Noordeen et al. (2022) identified seven challenges in microfinancing for microenterprises: higher return rate, incomplete documentation, lack of business ideas and plans, lack of skills and passion, non-viable businesses and projects, mismanagement of funds, and fraud.

In the Indonesian context, as explained by Prijadi, Wulandari, Desiana, Pinagara, and Novita (2020), microenterprises face unique financing challenges at different stages of development. During the ideation stage, financing is typically from family or friends, while during the start-up stage, it comes from the supply chain or business networks. Most SMEs do not use formal institutions, as their managers often lack knowledge or experience in financing matters. They also hesitate to borrow from formal financial institutions due to high rates and longer processing times. On the other hand, based on a literature review, Gandhi, Nurcahyo, and Gabriel (2021) stated that product certification is also a challenge for MSMEs in Indonesia. This is due to several

things, namely lack of financial resources, certification costs, low technological capability, technical production, weak management, organizational capacity, and qualified HR for certification implementation and maintenance which are challenges for product certification.

Rusliati, Mulyaningrum, Wibowo, and Narmaditya's (2020) study highlighted the impact of inadequate technology adaptation on micro-businesses, leading to customer loss and potential closure. This finding suggests that effective leadership, including managing the business, capturing opportunities, confidence, firmness, integrity, communication, and expertise, can drive business development. According to Djatmiko and Pudyastiwi (2020), the COVID-19 pandemic also has altered consumer buying patterns, with many still purchasing products in-store due to restrictions and government regulations. This has led to a need for MSME actors to adjust their sales strategies, focusing on product quality improvements and service adjustments to attract consumers. Sari (as cited in Suhandoko, 2023) highlighted four challenges for MSMEs in Indonesia: maintaining their digital ecosystem, increasing their capacity, quality, and productivity to contribute to the global economy and trade, expanding financial access, and raising environmental awareness of global threats.

According to Dagpin, Escaño, Mendoza, and Vertuso (2022), the COVID-19 pandemic severely impacted the global economy, making it difficult for enterprises to maintain operations. Common issues included limited direct marketing, online platform adoption, and work-from-home setups. Factors leading to business failure included realignment of goals, operational expenses, product innovation difficulties, and failure to adapt to changes. The other research conducted by Fabeil, Pazim, and Langgat (2020) in Sabah, Malaysia shows that the COVID-19 crisis has posed a significant challenge for microenterprises, who have shown resilience through business continuity approaches and recovery strategies, especially in product delivery and marketing. However, access to support and facilities is challenging for these businesses in less-developed areas, like the impact of environmental crises on rural island tourism businesses in Indonesia.

### **2.3.3 Strategy to Enhance the Development of Microenterprises**

Microenterprise has the potential to significantly impact social change and poverty alleviation, and its popularity is expected to rise in the next decade. To boost its popularity, more capital must be mobilized for innovative programs, interest generation, funding redirection, linking microenterprise to development programs, and business expansion (Fairley, 1998). Edgcomb, Clark, and Klein (1996) conducted a survey on microenterprise assistance in the U.S. and developing countries which focuses on individuals' ability to improve their lives through their talents, creativity, and hard work. These programs provide business assistance and small amounts of credit to support the development or start-up of businesses. The philosophy is affirming and transformative, starting where people are and recognising their economic worth. Microenterprise programs enter a social contract with clients, requiring explicit responsibilities and tangible services in exchange. This approach is unique in recognising the potential of target participants and promoting self-improvement. The study conducted by Martín-Tapia, Aragón-Correa, and Rueda-Manzanares (2010) revealed that SMEs can develop proactive environmental strategies, which can enhance their competitive performance. These strategies positively impact export intensity, with a stronger effect on SMEs. However, this effect depends on firm size and is more intense with larger firms.

Microenterprises face competition from larger corporations and e-commerce due to limited resources. To compete, they should identify the Blue Ocean, a marketplace with no competitors, as proposed by Kim and Mauborgne (2007). This strategy allows them to capture refined target segments and create their competitive advantages. Identifying a Blue Ocean involves considering alternative industries, strategic groups, buyer chains, complementary offerings, and buyer appeal. Servon and Doshna (2000) suggested a microenterprise strategy that educates planners and policymakers, integrates microenterprise development into a larger plan for a distressed region and evaluates the strategy using appropriate measures.

According to Janczewska (2017), the success of a business model is primarily attributed to marketing and logistics activities, which are more important than financial resources. These tasks are influenced by the company's operation and market, such as in the confectionery sector. Owners of SMEs should participate in developing their

mission, vision, and strategy, develop a modern marketing strategy, segment customers, improve customer loyalty programs, conduct research, create new needs, monitor the marketing environment, develop marketing-mix tools, and cooperate with other companies. These tasks contribute to the company's success and efficiency in logistics processes. Based on Servon's study (1998), microenterprise programs can help low-income individuals achieve economic self-sufficiency by assisting them in securing larger loans, avoiding narrow, low-income, minority markets, and providing specific training for emerging business areas. Women-focused programs can help them enter traditional male-dominated industries like skilled construction trades. However, these programs cannot turn disadvantaged individuals into successful entrepreneurs. Policymakers should focus on those most likely to succeed and identify the niche group within the larger group that is prepared for self-employment.

As mentioned before, the pandemic caused business failures due to goal alignment issues, operational expenses, product innovation challenges, and failure to adapt. Microenterprises used exit strategies like bankruptcy, refinancing, and selling to family or friends. In that condition, Escaña et al. (2022) recommended crisis-sensitive interventions like government financial safety nets, retooling, and training of pandemic-sensitive enterprise strategies for microenterprises. The study conducted by Cheing, Hong, Kuek, Chai, and Cham (2020) found that Facebook's use as a social media strategy in F&B microenterprises improved repeat customer visits, sales growth, and word-of-mouth marketing. It emphasized the importance of higher marketing visibility and speed of communication, suggesting sales increment, customer retention, and viral marketing as key indicators for strategic planning evaluation. Microenterprises should be provided with necessary assistance and support facilities, especially in crisis management methods, such as online marketing techniques, product delivery procedures, new product development, costing and pricing strategies, and customer database management, to effectively manage their businesses during crises (Fabeil et al., 2020). According to Carlson's (2023) study of nearly 10,000 microenterprises across eight developing countries across the world, there is a larger correlation between performance and distinction among female microenterprise owners. Education and age have a positive and negative impact on differentiation, respectively, whereas policy interventions have minimal bearing.

Fabeil, Pazim, and Langga (2020) examined the business survival strategies of 60 micro-entrepreneurs in Sabah during five phases of movement control orders in Malaysia. Results show that microenterprises experienced a more severe impact of the pandemic than natural disasters, terrorist attacks, or political crises. Most micro-entrepreneurs chose online business as their main survival approach, and despite feeling well-prepared, they only managed to survive for 3-5 months of the crisis. Ngenoh, Kariuki, Gathungu, and Kiprop's study (2020) in Migori County, Kenya, found that the most common marketing strategies used by cassava microenterprises include pricing, product promotion, value addition, and alliance formation. Factors such as age, gender, education, household size, major occupation, marketing experience, seed money, entrepreneurial training, market distance, group membership, farm gate, and open-air outlets significantly influenced the choice of marketing strategies. Therefore, combining viable product lines with optimal performance strategies can increase marketing shares and profits. Carranza, Ibarra, and López-Lemus' study (2021) in Guanajuato, Mexico emphasized the significance of strategic planning (SP) in the success of microenterprises, highlighting its role in achieving tangible and intangible results. It suggests that entrepreneurs should develop and apply SP to enhance their firm's results, focusing on strategic vision, objectives, and market positioning.

In the Indonesian context, the COVID-19 pandemic has significantly impacted MSMEs, particularly those not fully adapted to the Industrial Revolution 4.0. Facing these conditions, various efforts have been made not only by the government but also by non-governmental institutions. For example, the BRI Microfinance Center program is implemented as a strategy that includes both direct and virtual empowerment programs to support MSMEs during the crisis (Tanaya & Ekyawan, 2020). Direct programs include training workshops, technical training, and collaborations with related institutions. Virtual programs include BRILian entrepreneurship, WhatsApp groups, and virtual training and workshops. The other case is the program of the micro and medium enterprises cooperatives office in Bogor Regency which implements a program to boost the entrepreneurial competence of MSME actors (Warcito, Hamidah, & Yohanna, 2021). The strategy includes increasing commitment, improving resource capacity, improving data management, increasing microenterprises productivity, and enhancing coordination across regional apparatuses, vertical agencies, and stakeholders.

According to Rusliati et al. (2020), technological adaptation is crucial for microenterprise development, with millennials implementing technology more creatively than previous generations. Inadequate technology adaptation can lead to customer loss and business closure. Leadership plays a significant role in business development, with increased sales, diverse products, and increased capital and employees. Establishing an entrepreneur group facilitates peer-to-peer contact, knowledge transfer, training, and intervention. The other research conducted by Akhmad, Khalid, and Asdar (2023) in Gowa Regency showed that MSME products require packaging development, standardization, and certification to achieve global competitiveness. The Indonesian national standard (SNI) should be socialized to enhance economic value and competitiveness. Strengthening business management, increasing capacity, and fostering friendly financial institutions can support the cooperative and SME ecosystem. HR capacity in cooperatives and MSMEs must be strengthened. The Gowa Regency government is empowering MSME actors to grow towards business independence by fostering entrepreneurial spirit and values. Entrepreneurship training is also aimed at increasing productivity. Despite facing local and international competition, the development of MSME in the Gowa Regency is increasing, demonstrating its ability to maintain business during crises. Focusing on five priority components: Cost, Quality, Flexibility, Delivery, and Innovation is crucial.

The study conducted by Sari and Kusumawati (2022) suggested several programs that can enhance MSME compatibility in Indonesia, including collaborating with government, social agencies, and universities, providing public education on business management and entrepreneurship, developing digital technologies, providing access to capital, e-on learning, creating market-oriented policies, providing information, building an innovative culture, and promoting entrepreneurship exhibitions and seminars to boost competitiveness. Indonesia's micro-business units, with 90% engaged in home-scale activities, require increased capacity and competitiveness through legal, financial, and HR management. Institutions can be formed to make micro-businesses more banking friendly. The Quadruple Helix innovation model, focusing on cooperation between government, companies, investors, university academics, and community actors, can help build independent micro-businesses and promote equitable economic development (Hakim, Mulyati, Hasan, & Murwadji, 2021).

### **2.3.4 Microenterprise Financing Across the Countries**

Lack of finance remains one of the biggest barriers to the success of most entrepreneurial ideas and startups, as well as the growth of new ventures. Identification of additional funding sources is important for companies, especially at the micro and small-scale companies. For example, in Nigeria, the inability of low-income groups to access formal credit, especially in rural areas, has a direct effect on the growth of micro and small enterprises. The main informal source of funding for many households is cooperative organizations that are formed and managed by the people. In this case, the role of cooperatives can be increased to become a financial institution providing micro-loans. However, as stated by Abdullahi (2018), the Nigerian government has failed to utilize cooperatives as a potential means of distributing microcredit to microenterprises. The policy only mentions cooperatives as a means of poverty alleviation and village development, but not for financing MSMEs (Nwankno, 2012). The financial services for credit lenders are provided directly through special government institutions (e.g. the Agricultural Bank, Industrial Bank, and the National Economic Reconstruction Fund). The need to address the problem of providing services to marginalized individuals and microenterprises towards accelerating the achievement of financial inclusion in the economy. Therefore, there is a public policy that aims to expand access to financial services for individuals and micro-entrepreneurs. However, implementation of this is constrained by restrictions related to the financial sector's consideration of loan risk and service profitability that excludes microenterprises.

In terms of access to credit for microenterprises, the experience in Bangladesh as explained by Muneer (2018) stated that the dominant transformation from agricultural to non-agricultural activities has influenced policies on industrial development in the country. Most of these economic households are microenterprises (including home-based businesses). However, despite having a small share in the economic unit, SMEs occupy a leading position in Bangladesh's industrial development policy. While small businesses have a small share in total SME loans, microenterprises are largely lagging the formal banking system due to high transaction costs and the absence of a proper monitoring system. When compared to small businesses, microenterprises in Bangladesh experience more severe credit constraints where most of their business capital comes from the entrepreneur's funds. The MFI's assumption

that microenterprises do not have high returns makes financing difficult for microenterprises. However, the results of Muneer's study stated that microenterprises have higher returns than small-scale businesses. In addition, the results of the study (based on the sample used) also did not find companies that had negative benefits both in terms of finance and economy. From this explanation, it can be said that microenterprises are profitable for financial institutions. Financial institutions need to observe debt-equity ratios when providing loans given the empirical data showing that access to credit contributes to achieving broader development agendas such as job creation.

In the Remo division of Ogun State, Nigeria, Dada and Adefulu (2021) investigated the impact of cooperative credit facilities on the profitability of member firms. The study's findings indicate that the profitability of members' enterprises is significantly impacted by cooperative credit facilities. This research advises cooperative managers and owners to help cooperatives get financing facilities to boost the profitability of their businesses. This is due to the significant role cooperatives play in enabling financial access, input distribution and procurement, and product marketing. They make jobs possible, particularly in rural regions, and enable underprivileged people to band together for both social and commercial benefits. However, many cooperative members face significant obstacles to their capacity to turn a profit, including limited access to credit facilities and excessive borrowing costs.

To support the viability of increasing the government's lending commitment to guarantee the sustained growth of small enterprises, Yemelyanov et al. (2020) investigated the effectiveness and accessibility of microcredit for Ukrainian small businesses. The study's findings demonstrate that the proportion of microcredit in the overall amount of capital used to start the firm determines how efficiently microcredit is created for businesses over a period. Additionally, a linear link has been established between the growth rate of the firm's assets and the proportionate quantity of loans obtained. Considering the COVID-19 epidemic, this study backs the bolstering of governmental assistance for microcredit for small Ukrainian businesses.

Nangena (2020) investigated the financing preferences of MSMEs in the city of Bolgatanga and reviews the variables that affect these preferences. The findings of the

investigation indicate that businesses prioritise internal funding over external funding and that when external funding is necessary, informal funding is chosen by businesses ahead of semi-formal and formal funding. The data also indicates that the financing choices of a firm are influenced by several factors, including gender, location, institutional support, secondary education, age (established and mature), size (medium), and management training.

In a study where 80 percent of the recipients of microfinance were illiterate women, Kassim and Rahman (2018) found the incidence of default risk in microfinance at Grameen Bank in Bangladesh, demonstrating the importance of post-disbursement supervision in guaranteeing the success of microfinance. Mustafa (2017) researched the variables affecting Sudan's microfinance industry performance. The study's findings, which were obtained by contrasting the integrated qualitative and quantitative results, demonstrate that the variables pertaining to interest rates, loan terms, and customer protection are significantly and favourably correlated with MFI performance as seen from the standpoints of outreach and financial sustainability. Microinsurance predictors, however, did not correlate with MFI performance. Furthermore, the structural analysis's findings offer enough evidence to support the idea that the MFI's performance is influenced by its institutional features, clientele, organisational type, and founding year. However, the customer survey findings show that microloans favourably benefit MFI clients.

In Kwale District, Kenya, Mogaka (2018) investigated the effects of finance, investment, working capital management, and profit distribution decisions on turnover development in SMEs. As per the study's findings, there exists a reasonably substantial positive association between the financing decision and the rise in MSE turnover. There is a noteworthy and robust positive association between turnover increase and investment decisions. While profit distribution has a weakly positive association with the increase of MSE turnover in Kwale District, working capital management has a significant positive correlation with the growth of MSE turnover in Kwale District.

The usefulness of microcredit in enhancing micro and small companies in Indonesia was examined by Yusgiantoro, Simanjuntak, Wirdiyanti, Pratomo, and Sugeng (2019). The results of the analysis found a significant difference between

microcredit borrowers and non-borrowers where the first group experienced an increase in turnover and profits compared to the second group. However, the performance of the two samples does not affect financial inclusion. The microcredit program does not shape the saving behaviour of micro and small entrepreneurs as part of the aspect of financial inclusion. This finding implies that government intervention through the provision of microcredit is essential to improve the performance of micro-small enterprises and, at the same time, provide technical assistance to improve their loan and savings management.

Suseno's (2020) study on BMT revealed that finding quantitative data on financial issues in Indonesia was challenging. One of the causes is the lack of data synchronisation in microfinance, particularly for non-bank or cooperative institutions such as NGOs, government microfinance initiatives, or other unofficial organisations. According to the existing data, there are a minimum of seven distinct categories of MFIs in Indonesia, each with a unique funding approach and oversight from disparate regulatory bodies, even if their target market groups may overlap. For instance, BMT employs a mixed strategy of financial and social intermediaries, whereas BPRS just uses a financial intermediation method when offering services to MSMEs and the poor.

Herianingrum and Shofawati (2019) study explores the economic empowerment of microenterprises in East Java, Indonesia, using Sharia microfinance institutions. The study found that both members and non-members of the institution greatly benefit from murabahah and mudarabah financing, aiding in business continuity.

### **2.3.5 Prospects and Challenges of IMFIs to Become Microenterprise Partners**

Microfinance reduces poverty by directing loans provided in subsequent years toward productive economic activities. Income and savings will progressively rise to the point that the household will no longer need to borrow money. At this stage, the household no longer qualifies as impoverished and becomes a full-fledged microenterprise. However, some recent reports indicate that these groups are unable to meet some of their aims. In addition, MFIs are still dealing with asymmetric information. Practically, the bulk of loans made by microfinance firms are made to women. Indeed, the male members of the home begin to borrow and manage the cash generated by the female

members. The likelihood of default rises when loans are utilized for non-productive activities. Furthermore, most MFIs are not commercially sustainable because of a lack of capital mobilization and expensive operational costs. The funds' operations may also involve low-productivity tasks. Several studies have found that the rate of return on credit provided to women is poor because they participate in low-productivity activities. Microfinance does not represent the poorest of the poor, who either do not get loans or opt out of credit programs. The targeting of women as MFI credit recipients causes stress in the home. This is because the benefactor of the funds and the consumer are two separate people. The debt trap, which happens when borrowers borrow from other sources to make payments and become stuck in a spiralling debt cycle, is the other limitation. On the other hand, less than 1% of the overall global microfinance outreach is focused on Islamic values (Khan & Phillips, 2010). For fear of compromising their religious convictions, a substantial number of Muslims avoid utilising interest-based microfinance programs. Microfinance providers are attempting to meet the expectations of their donors. Many program workers are inspired by their belief in creating Sharia-compliant microfinance alternatives to interest-based finance.

Certain methods can be used to address IMFIs problems (Rahman & Dean, 2013). Postal networks within the region of operation can be used to compensate for the lack of a branch network for IMFIs. This may be accomplished through establishing networks for the growth of IMFIs and making financial services available to self-employed individuals, those with irregular earnings, and the rural population in general. The primary issue separating Islamic banks and microfinance is the issue of risk. To handle a bank's assets and obligations, the banking sector requires effective and efficient procedures and instruments. The government is critical in allowing IMFIs to establish policies. Islamic banks can employ a variety of deposits for safekeeping, including safeguarding (Wadiah) deposits. Deposits are considered interest-free loans by Qardhul hasan loans. Mudarabah deposits are subject to a profit-sharing arrangement, which means that losses are borne by the depositor. Cell phone market penetration is significantly higher, and it provides a solution to the high transaction costs encountered by many microcredit providers. Customers may use e-wallet cards to withdraw cash, replenish airtime, pay bills, and make deposits and money transfers. Critics have questioned the effectiveness of microfinance in relieving poverty. Islamic banks must consider their corporate social responsibility and seek to diversify their holdings to

include the poor. Financial exclusion can only be effectively addressed in the context of a well-conceived, well-founded, and well-integrated overarching policy structure inside the financial sector. Language difficulties and other socioeconomic reasons may also hamper efforts in poverty alleviation.

Good IMFIs programs are distinguished by small, short-term loans that are generally easy to get, as well as fast and trustworthy investment assessments. Following prompt repayment, easy placement, and timing of services, the quick disbursement of recurring loans enhances the loan's productivity. Successful operations have attained the required size, as measured by the number of loans. Islamic MFIs are improving access to financial services for a growing number of low-income clients by providing them with simple and convenient financial services.

The IMFIs may be a solution to the problems faced by MFIs due to their distinct design compared to their conventional counterparts. Nevertheless, from the empirical study, Ahmed (2002) argued that there are some problems facing IMFIs. The first issue is dilution in the implementation of Islamic finance methods. Bay' mu'ajjal is the major form of funding employed by the IMFIs in this scenario. To make the transaction Islamically acceptable, IMFIs should ideally buy the goods/assets on the market and resell them to the recipient at a profit. IMFIs have gradually abandoned this practice as their operations have expanded. The objections offered are that it is too expensive (in terms of man-hours) and, at times, difficult to get the items/assets required by the receiver. Lack of funds becomes the second problem facing IMFIs. Officials of all three IMFIs conducted in Ahmed's (2002) empirical examination note that the lack of funds is hindering the expansion of their operations. The need for funds is highest during the initial phase of MFIs operations when the beneficiaries' savings are zero or minimal. According to the findings of the field research, Islamic institutions such as zakat, charity, and waqf have not yet been exploited as sources of income for IMFIs. The other concern is related to social development programs. Training on various aspects of MFIs operations will boost the performance of the institution. IMFIs can tap alternate sources of funding, such as zakat, charity, and waqf. Various Islamic methods of finance can be used for various activities. On both the liability and asset sides, the IMFIs are potentially richer. These groups may be incorporated into the microfinance program, which will significantly reduce overall poverty.

Microfinance is becoming more important in reducing poverty and boosting social development. However, the primary obstacles that practitioners face in the microfinance industry are outreach and sustainability (Zouari, Zeineb, & Nabi, 2013). Costly monitoring is also a problem for IMFIs, and it is becoming increasingly important in the case of benefit and loss sharing contracts. Furthermore, Zouari et al. (2013) highlighted the issues and possibilities of IMFIs. Microfinance is being created in nations with strong regulatory and supervisory frameworks, such as Pakistan, Indonesia, and Uganda. Specialized government bodies (like central banks) often play an important role in strengthening MFIs. Central banks contribute to the development of the financial sector and promote the implementation of best practices. According to the research, a supporting legislative framework must be established at some point in time to improve the regulatory system in OIC nations. Microfinance activities, which include lending, investment, and insurance, are analogous to financial and institutional banking operations. To maintain the MFI's stability and profitability, financial regulation appears to be necessary for microfinance banks or public deposit-taking institutions. Islamic microfinance cannot be established without ongoing legislative and judicial reform. Customers with modest incomes are also less educated and less familiar with formal financial services. They will embrace sophisticated Islamic microfinance packages without fully understanding its goals and financial mechanics. They put their trust in the IMFIs' adherence to Islamic law in their products and services.

Other limits to the long-term viability of IMFIs' existing practice are explained by Segrado (2005). Poor market penetration, because of a lack of capital mobilization and expensive administrative expenses, is the primary challenge confronting IMFIs. Because of the sustainability of IMFIs, most MFIs and IMFIs are not economically viable. Other obstacles include the fact that, due to asymmetric data issues, IMFIs generally incur higher transaction costs. Small loans are expensive due to high operating rates, which generally have a substantial fixed cost attached. Poor infrastructure makes it difficult for IMFIs to obtain information about the prospects of their consumers. The high expense of monitoring is due to loans being utilized for reasons different from those stated in the initial agreement. Monitoring each loan by a subcommittee is both expensive and inexpensive. Other issues confronting IMFIs include the efficacy of poverty alleviation, with research indicating that one-year credit is less successful in poverty reduction than many loans over a longer period.

### **2.3.6 BMT and Microenterprise Financing in Indonesia**

Through profit sharing with small enterprises, BMT is a microfinance organisation that seeks to enhance economic business and community welfare. BMTs were first founded by prominent members of the community and function under an Islamic economic framework that prioritises security, fairness, harmony, and wealth (Anwar, Ridlwan, & Laili, 2023). One of the few semi-formal Islamic microfinance companies, it started operations in the 1980s and continued with a limited clientele into the 1990s. In keeping with the goals of MFIs generally, BMT was established as an endeavour to reach out to money-lending institutions for the underprivileged. As a substitute non-banking organisation affected by the 1998 financial crisis, BMT grew significantly. As of 2010, BMT had over 3900 branches in Indonesia. In addition, BMTs serve as social hubs, gathering and distributing ZISWAF (zakat, infaq, sadaqah, and waqf) for the benefit of mustahiq. BMTs seek to enhance communal welfare and the standard of economic enterprise by operating under Sharia law. Anwar et al., (2023) highlights the function of the BMT in fostering an Islamic economic system and averting societal usury. In addition to serving as supervisors and extension officers, BMT offers small enterprises fund, coaching, and mentoring. By offering wholesome money handled in accordance with Sharia economic principles, it seeks to free society from its reliance on loan sharks. Identifying, organising, fostering, and growing economic potential are among the tasks performed by BMT. Other tasks include enhancing HR, recognising and utilising community potential, and acting as the financial intermediary. To collect financial contributions and help the ummah, BMT was established, but it has to overcome several obstacles, including a lack of knowledge about the Islamic economy, finance, capital, low public engagement, few HR, regulation, and BMT management strategies (Anwar et al., 2023). Economic empowerment is crucial for regional economic growth, particularly in maximising the potential for MSME development, and should be encouraged to ensure its success.

Furthermore, Anwar et al. (2023) argued that Law Number 25 of 1992 addressing cooperatives provided a provisional legal foundation for BMTs, which were first associated with low-income individuals. However, because of its narrow goals, BMT activities are not permitted to employ Law Number 16 of 2001 concerning foundations, as revised by Law Number 28 of 2004. The 2013 Law No. 1 defined BMT's

organisational structure, enabling them to operate as limited liability companies (PT) or cooperative legal organisations. The Financial Services Authority Regulations (POJK) and the Law on Microfinance Institutions apply to BMTs which some of BMTs were governed by OJK and opposed to become MFIs. Some scholars argue that this government rules have now shifted BMT's operational focus from social activities to profit-making, more in line with banking practices. Act No. 1 of 2013 mandates the conversion of MFIs and IMFIs without a body into shareholder businesses or cooperatives. This is in line with Nugroho (2015) statement that BMT is one such institution that presently needs to change into a more professional organisation. This modification is anticipated to handle upcoming difficulties in the industry. In addition, there are currently no accounting standards or reporting regulations in Indonesia due to the Islamic Saving and Loan Cooperatives' (KSPPS) rapid expansion. Wahyuni (2008) found that more than 50% of BMTs print their income statements and balance sheets monthly, and 14% do so even every day. However, due to the low enforcement, BMT management is discouraged from having outside auditors review its financial statements. Members and depositors of BMT face prudential risks because of the absence of oversight and restrictions. In addition to increasing national supervisory organisations, regulations, and advice for BMT, the Indonesian government should also increase the incentives offered to BMT managers to increase their responsibility.

Under Law No. 17 of 2012, the Indonesian government approved BMT under cooperative rules. In 2020, BMT has printed BMT Principal Guidelines as a written document to identify external challenges and opportunities. Macroeconomic dynamics, banking, regulations, labour markets, demographics, poverty, social and economic challenges, and other subjects are a few examples of those challenges and opportunities. The approval and declaration of Law Number 1 of 2013 improved the oversight, regulation, and direction of BMTs under the MFIs (UULKM). Cooperatives foundations, limited liability corporations, and even non-governmental organizations were formerly permitted as BMT legal formations. Since the enactment of UULKM in 2013, BMT has had the institutional status of a cooperative or limited liability corporation. So, to date, the bulk of BMT legal organizations in Indonesia are cooperatives whose growth and monitoring fall within the jurisdiction of cooperative and SME services. Nonetheless, under some circumstances, BMT may be transformed into an MFI, subject to guidelines based on the 2013 UULKM and oversight and

guidance from three agencies: the Ministry of Home Affairs, the Ministry of Cooperatives and SMEs, and the OJK. In this case, OJK acts as an overseer, a regulator, and the person who grants these MFIs company licences. Islamic microfinance aims to assist the poor in the informal sector by providing interest-free funding through zakat, infaq, and sadaqah. This aligns with Islamic ethical values and enhances social services by employing zakat to meet basic needs, thereby enhancing the lives of the poorest in the sector.

In Indonesia, BMTs function as semi-formal MFIs under the supervision of the Ministry of Cooperatives and SMEs. This is another kind of social enterprise entrepreneurship, and it is usually paired with a few micro-business owners. The Ministry of Social Affairs of the Republic of Indonesia provides help for them. Two of them are BMT Kube, which has 87 branches spread throughout 19 provinces, and PINBUK (Small Business Incubation Centre), which was instrumental in the founding of BMT. Nearly 4,000 BMTs are on file with PINBUK. In addition, several people in the BOP receive financial assistance from Sharia Pawnshops, Sharia Savings and Loans Unit (USP), and Sharia Savings and Loans Unit (KSP), all of which are categorised as semi-formal MFIs according to Sharia law; nevertheless, their market share is smaller than that of BMT.

In this regard, an increasing number of BMTs are working in tandem with the Organisation of Sharia Cooperative (Inkopsyah) to provide funding and other services, such as training in financial literacy. BMT offers a special position known as Baitul Maal, which is performed as an amil who manages funds and savings in addition to administering, collecting, and distributing zakat. Given that it pertains to both social and commercial organisations, this has two purposes. BMT uses the funds of qardhul hasan to carry out its social mission. BMT serves an important role as a cooperative based on the idea of profit sharing based on Islamic principles and collective actions to decrease risk.

Counselling and frequent meetings are examples of collective activities that comply with MFIs. Furthermore, because BMT provides speedier approval for the disbursement of money than other financial institutions, microenterprises are more likely to request finance from BMT. Baitul Tamwil emphasises micro-entrepreneurs

who have a record of accomplishment of obtaining money from private loan sharks. BMT is governed by a Sharia financial system, and its operations are based on the idea of trust and can be relied on by all parties involved. As a type of collaboration, BMT requires strategic relationships. This will blur the lines between Islamic banks and BMTs, resulting in the close connection that the two parties are expected to establish.

Another term for social capital is also necessary to achieve the ability of the community to establish ties among its members. It is an important resource for ensuring one's social and economic existence. The two missions of the MFIs are social interactions and financial growth. The term "financial connections" refers to several programmes that offer low-income or impoverished people at the base of the income distribution pyramid financial products and services for savings, loans, insurance, and transfers. The route that BMT can follow to accomplish this aim should play a significant part in social link development as a resource for building HR. It can therefore increase the impoverished's trust in official financial intermediation.

BMT is dealing with several issues as it grows, including issues of institutional legality, financial performance, and institutional management (Wulandari & Pramesti, 2021). In terms of legal reinforcement, OJK oversees the regulation, monitoring, and development of BMTs that have been converted into MFIs by Law No. 1/2013. However, several elements of financial activity, particularly in BMT, are not supported by this regulation. APEX BMT, on the other hand, was created in 2013 to facilitate the matter to enhance the business level, feasibility, and prospects, and confirm profitable development. It also serves as a fund-raising organization, a financial transaction company, a membership training company, a wholesale finance company, a rating agency, an information centre, and an IT service provider. Nonetheless, the efficiency of the reality of the BMT affiliate's existence remains uncertain (Wulandari & Pramesti, 2021).

Another problem faced by BMT is the low quality of financial performance which affects the trust of donors providing additional funds for BMT. Whereas financial performance is important in the sustainability of a financial institution. Management is also one of the problems faced by BMTs, especially small BMTs which are threatened with bankruptcy due to poor institutional and financial management. Wulandari and

Pramesti (2021) recommend several strategies for implementing sustainable Sharia microfinance, including designing new loan limit formulations, increasing good knowledge of standard financial reports, reducing operational costs with mobile banking applications, minimising non-performing financing, and preparing liabilities. On the other hand, OJK, as a coordinator, works closely with other ministries, including the Ministry of Cooperatives and SMEs and the Ministry of Home Affairs.

Lack of funding continues to be one of the most significant barriers to the success of most entrepreneurial concepts and enterprises, as well as the expansion of start-ups. Identifying additional sources of finance is very important for businesses, especially micro and small businesses. IMFIs is becoming more important in reducing poverty and promoting social development. Some contracts, such as murabahah, mudarabah, musharakah, ijarah, and qardhul hasan, offer many opportunities for improvement and adaptation as Islamic microfinance schemes. However, the reality is that micro-entrepreneurs account for a small part of overall SME loans, and microenterprises lag far behind the conventional banking system due to high transaction costs and lack of proper monitoring. In addition, the main obstacles facing microfinance institutions such as the IMFIs are outreach and sustainability.

IMFIs face challenges in expensive monitoring, particularly for customers with low income, less education, and less familiarity with formal financial services. They will accept a sophisticated Islamic microfinance package without fully understanding its financial objectives and mechanisms. When IFIs design investment contracts, they are presented with asymmetric information projects with a degree of adverse selection and severe moral hazard. Asymmetric information is divided into two categories: hidden actions and hidden information. Moral hazard is caused by hidden actions, while adverse selection is caused by hidden information.

Research on BMT reveals its significant role in poverty reduction and business growth for small merchants, with Wulandari (2019) highlighting its impact on turnover, assets, revenue, and stability, while Indraswari and Fauzi (2019) highlight its significant role. Nonetheless, for BMT to be successful in Indonesia, several stage-specific responsibilities and structures are required (Wulandari, 2019). Baitul Maal's role needs to be distinguished from Baitul Tamwil's to strengthen its influence while providing

Qardhul Hassan funds to the BOP personnel. This institution has significantly boosted the income of microentrepreneurs' households and businesses, leading to a decline in the percentage of the impoverished (Febianto et al, 2019).

The majority of BMTs in Indonesia operate in the highly competitive financial sector, where their primary goal is to survive. Stated differently, because a job only lasts so long, it is susceptible to corporate upheaval. Due to its promising revenue potential, commercial microfinance services in Indonesia are competitive, not just because of the knowledge of the empowerment factor ingrained in their goal. Since microfinance has become more commercialised in Indonesia, BMT, which strives to empower individuals economically, should concentrate on both role selection and personal transformation. Its function and position are changed to one of two options: commercial or social, and this transition is accomplished by supporting it with sound corporate governance (Husaeni & Dew, 2019).

In their research, Fitriasaki and Dalimunthe (2019) discovered that linkage programmes were beneficial, particularly in terms of enhancing the outreach's affordability in small and medium-sized businesses—but not in big BMTs. However, disagreement, cooperation, and trust have been shown to influence the success of knowledge transmission positively and significantly. Islamic banks and BMT maintain a contractual relationship in their strategic cooperation, where confidence is conditioned upon performance. Other than that, the development of coordination, agreement, interdependence, and social capital has a substantial positive impact on trust and knowledge transmission (Wahyudi, 2013). Moreover, Wahyudi (2014) states that dedication has a beneficial role in reaching an alliance's financial objectives. Furthermore, the formation of commitment from BMT and confidence from Islamic banks is positively and significantly impacted by cooperation and first agreement. In addition to the original agreement and cooperation, BMT's social capital was another factor that contributed to Islamic banks' confidence.

Wulandari and Kassim (2016) argue that collateral and credit default are significant hurdles to providing loans to the poor. These scholars suggest that charitable contributions and Islamic levies could help mitigate funding failures, while emphasizing the need for religious capacity building in risk management, but also

highlight challenges like insufficient community support and limited funding. The primary issue facing BMT in Indonesia is the public's lack of interest in Sharia-based information and its vulnerabilities in information technology and infrastructure. To survive and grow, Indonesia needs more industry focus and certain restrictions, and resolving these issues is crucial for its success (Anwar et al., 2023).

Other study conducted by Mutamimah, Zaenudin, and Cokrohadisumarto's (2022) reveals that BTMs face various risks, including Sharia compliance, financing, market, and operational risks. Their divine mission is their top priority, and they aim to support good business governance in Sharia compliance. Financing, markets, and operations are the second most controlled risks, but survival is threatened by high non-performing loans, lack of competition, and disregard for organizational norms. Legal, liquidity, strategic, and HR-related risks are the fifth most prevalent. To improve, BTMs should form a risk management committee, enhance employee selection, development, and training, and improve government regulation, particularly in IMFIs.

## **2.4 CONCLUSION**

Current research and literature highlight the development, role, issues, and challenges of IMFIs, particularly in the Indonesian context. IMFIs play a crucial role in alleviating poverty, particularly in developing countries, but also face challenges, particularly with SMEs, due to their majority membership.

## **CHAPTER THREE**

### **AGENCY THEORY AND ITS RELATION TO ISLAMIC FINANCIAL CONTRACT**

#### **3.1 INTRODUCTION**

A theory is a structured collection of interconnected statements that help understand the relationships between variables and phenomena. It helps in interpreting complex facts and observations, allowing researchers to formulate comprehensive statements. Theories are essential in research and practical applications, consolidating knowledge, valuing empirical observations, and providing a systematic framework for understanding and forecasting phenomena. Concepts, which can be theoretical or operational, are the fundamental building blocks of a theory, articulating the nature of phenomena and evolving within personal experiences. Abstract ideas, such as constructs, encompass intangible behaviours, while observable behaviour refers to the behaviour resulting from the postulated construct (Fain, 2009). In this chapter, we will discuss the literature review related to relevant theories and concepts, empirical evidence related to research themes, and identification of research gaps based on existing literature.

#### **3.2 AGENCY THEORY**

An old theory of economics and management that deals with problems in businesses brought on by the division of owners and managers is called the agency model. Its main goals are to lessen this issue and put in place governance systems to regulate the behaviour of agents in jointly owned businesses. Individuals or groups own ownership in joint stock companies, and shareholders provide authority to agents to manage the firm on their behalf. According to Panda and Leepsa (2017), the primary concern is whether these managers are working for the owners or themselves and that designated agents manage big companies and conduct business, which causes tensions between principals and agents. Risk-sharing between collaborating parties, where the principle assumes risks and the agents maximise their own gains, is how the agency conflict

is explained. The idea was developed by Ross and Mitnick (in Leepsa, 2017), who concentrated on incentives and institutional design. Compensation decisions are what Ross recognised as the root of the principal-agent dilemma, whereas Mitnick's institutional approach posited that institutions are constructed around an agency and evolve to accommodate it.

The theory of agency, along with two other theories—the theory of property rights and financial theory—was presented by Jensen and Meckling in 1976. This theory, known as the firm theory, later served as a model for the advancement of accounting research globally (Uzaimi, 2017). To create a theory of the ownership structure of the business, Jensen and Meckling (1976) integrated aspects from the theories of agency, property rights, and finance. Jensen and Meckling (1976) defined the term "agency costs," illustrate how it relates to the "separation and control" dilemma, explore the types of agency costs brought about by debt and outside equity, show who is responsible for paying these costs and why, and investigate whether their existence is Pareto optimal. Additionally, they offer a revised definition of the company and demonstrate how the supply side of the completeness of markets problem is a specific example of their examination of the variables impacting the formation and issuance of debt and equity claims. According to Jensen and Meckling's (1976) thesis, the issue of "capital structure" also involves the relative ownership claims held by outsiders (investors who do not directly participate in the firm's management) and insiders (management).

Related to the theory of the firm, recent attempts to construct a firm theory have been made by substituting other models for profit or value maximization, believing it is inadequate to explain managerial behaviour in large corporations. Some reformulations have rejected the fundamental principle of maximising behaviour. Jensen and Meckling retained the notion of maximising behaviour on the part of all individuals in the analysis to follow. In their paper, Jensen and Meckling focused on the behavioural implications of the property rights specified in the contracts between the owners and managers of the firm. Jensen and Meckling (1976) asserted that an agency relationship is a contract where a principal engages an agent to perform a service on their behalf, delegating decision-making authority. If both parties are utility maximisers, the agent may not always act in the principal's best interests. The principal can limit divergences by setting

appropriate incentives and incurring monitoring costs to limit the agent's aberrant activities. In some cases, the agent may be paid bonding costs to guarantee the principal will not take actions that would harm the principal or compensate them if they do. However, it is usually impossible for the principal or agent to guarantee optimal decisions from the principal's viewpoint. In most agency relationships, the principal and agent will incur positive monitoring and bonding costs, and there may be some divergence between the agent's decisions and those that would maximize the principal's welfare. This cost, known as the "residual loss," is the dollar equivalent of the reduction in welfare experienced by the principal due to this divergence. Jensen and Meckling defined agency cost as the sum of the principal's monitoring expenditures, the agent's bonding expenditures, and the residual loss. They arise in situations involving cooperative effort, such as co-authoring a paper by two or more people, even without a clear principal-agent relationship. The definition of agency costs and their importance to the firm theory is closely related to the problem of shirking and monitoring team production, as raised by Alchian and Demsetz (1972).

Alchian and Demsetz (1972) and Jensen and Meckling (1976) defined a firm as a set of contracts between factors of production, with agency relationships being a type of contract between the principal and agent. Both parties work for their self-interest, leading to agency conflict. Principals exercise monitoring activities to control the agency's costs, while labour market and information asymmetry play a crucial role in the principal-agent contract. Jensen and Meckling (1976) portrayed the firm as a black box that maximizes value and profitability through proper coordination and teamwork. Fama (1980) advocated for firms to be disciplined by competition from other players, monitoring the performance of the entire team and individual persons. Fama and Jensen (1983) studied the decision-making process and residual claimants, segregating it into decision management and control, with agents being key players. Grossman and Hart (1983) discussed the divergence of risk preference between principal and agents, suggesting that the principal should trade off the agent's behaviour with a proper payment structure using an algorithmic model. Eisenhardt (1989) categorized the agency theory into two models: the positivist agency model and the principal-agent model.

Agency theory, a concept in sociology, explores the interplay between agent selection, preferences, incentives, monitoring, and sanctioning in the "acting for" relationships. This theory is often referred to as bureaucracy, organizations, professions, roles, markets, labour, government, family, trust, and social exchange. Sociologists draw on agency theory in other disciplines to examine sites along the social landscape where agency is prominent and to investigate in empirical detail how principals and agents choreograph their dance. Sociology offers more than just examining sites along the social landscape but also offers insights into how principals and agents choreograph their interactions (Shapiro, 2005).

According to agency theory, agency relationships include transferring some decision-making responsibility to agents. If both parties are utility maximizers, there is reason to think that the agent will not always operate in the principal's best interests. Principals can prevent conflicts of interest by providing suitable incentives to agents and paying monitoring fees (Jensen & Meckling, 1976). Agency theory is a concept based on three assumptions about human nature: selfishness, limited rationality, and risk aversion. It explains that an agency relationship is a contract where one or more people bind another person (the agent) to provide services at their discretion. The theory aims to identify the most efficient contracts for interactions between principals and agents. According to agency theory, everyone behaves in their self-interest, with shareholders focusing on increasing their financial returns. Agents serve their interests by providing appropriate compensation and bonuses, while principals evaluate agents based on their ability to increase dividend income. If both parties are utility maximizers, the agent may not always act in the principal's best interest. Principals can limit deviance by providing incentives and adjusting monitoring costs. Agency theory offers unique insights into information systems, outcome uncertainty, incentives, and risk, and is empirically valid when combined with the agency perspective. It is particularly useful in studying cooperative structures and cooperative problems.

Related to agency theory, Hill and Jones (1992) argued that markets are efficient, but short-term imbalances can lead to temporary power disparities between managers and stakeholders. Managers may exploit these differences, leading to the emergence of incentive structures and institutional systems to monitor and enforce contractual bonds between managers and stakeholders. Conflicts between principals

and agents can lead to disproportionate or unbalanced asymmetric information, which arises from an unequal distribution of knowledge. Moral hazard occurs when agents fail to complete responsibilities specified in the employment contract. Principals hire agents to perform tasks, including allocating certain behavioural responsibilities. Because both stakeholders are utility-maximising, it is possible that agents may not always act in the principal's best interest. To limit deviation from their interests, principals can provide appropriate compensation to employees and charge supervision fees to control deviant agent behaviour. This principle can help manage unequal resource dependencies and ensure fairness in the market.

It is often difficult for either the principal or the agent to be certain that the agent will make the best decision for the principal at the lowest feasible cost. In most agency partnerships, the expenses of good monitoring and involvement are shared by the principal and agent. Furthermore, there will be a discrepancy between the agent's decision and the decision that will maximize the principal's welfare. As mentioned before, the agency cost, also known as the residual loss, is the value equivalent to the reduction in the principal's welfare due to this difference, calculated by adding the principal's monitoring costs, bonding agent's bonding costs, and the residual loss (Jensen & Meckling, 1976). This kind of view is referred to as agency theory. In other words, agency theory believes that people are exclusively driven by self-interest. If there is cooperative conduct in which an attempt is made to maximise the welfare of the group (collectively), this is incompatible with agency theory. Agency theory can emerge when self-interest (without compulsion) is incompatible with group cooperative conduct, or when inefficient group cooperative behaviour results (Baiman, 1990).

Uzaimi (2017) described several characteristics of agency relationships, including that principals and agents are assumed to act rationally, both aiming to maximise utility or personal interests and in general as if to maximise the benefits of the other party (principal-agent) and there is no group cooperative behaviour. The consequence of all that is the emergence of agency costs. In other words, it cannot tolerate the slightest mistake made by the agent that causes investment losses. On the other hand, the agent will not do the best thing because the agent must provide benefits to the principal. However, what the agent does is none other than how the agent can also get big profits from simple sacrifices (risk and work averse) (Baiman, 1990). This

theory of distrust of each other is recognised as normal behaviour in business. Cooperative behaviour (mutual benefit without coercion) will be inconsistent. This whole thing ultimately leads (drives) each party to add work instruments to be sure that the contract agreement is not detrimental. In other words, a contract of mutual trust is made for mutual distrust.

Before 1976, financial theory generally used standard economic models to describe corporate behaviour (Arifin as cited in Ardiansyah, 2014). In this model, the company is considered a “black box” (no role) in processing inputs into outputs. Financial theory seems to ignore that in companies there are managers, so the assumption that was often used at that time is that companies are controlled and managed by their owners. When the company is no longer managed by the owner himself, it is very likely that the manager will not act in the interests of the owner (shareholders) but instead act in his own interest.

As mentioned before, Jensen and Meckling (1976) were the first to include the human element in a unified model of corporate behaviour. Both scholars tried to develop a theory of corporate ownership structure by combining three existing theories, namely the theory of property right, the theory of agency, and the theory of finance. Property rights theory is concerned with the definition of personal rights that govern how much expenses and benefits will be distributed among organization participants. Agency theory will provide a framework for conducting economic analysis based on the contractual relationship between the principal and the agent. Meanwhile, financial theory focuses on how the company's capital is obtained, where the company's capital structure affects the contractual relationship between investors and managers.

Jensen and Meckling (1976) began the analysis by describing the agency problem with the main question of why entrepreneurs or managers of companies that a mixed capital structure (partly owned by managers and partly by outsiders) choose activities in such a way that the total value of the company will be lower than the total value of the company if they become the sole owner. For this reason, Jensen and Meckling created a scenario where an individual who owns one hundred percent of the company sells some non-voting shares to outsiders, but the individual still manages the company. These individuals get benefits in the form of money (called pecuniary

benefits) and non-pecuniary benefits such as on-the-job leisure or shirking, workplace interest, and so on. The focus of agency theory regulates the relationship between principals and agents with several assumptions: 1) about humans, who are self-interested, have bounded rationality, tend to avoid risk (risk-aversion); 2) regarding the organization, where there is a conflict of interest among its members; and 3) regarding information, where information is a commodity and can be purchased (Eisenhardt, 1989).

Agency theory emphasises solving two problems that can occur as a result of the contractual relationship between the agent and the principal, namely: first, the agency problem, which arises because of the different objectives of the principal and the agent, and it is difficult or expensive for the principal to verify the real work of the agent; and second, the problem of risk-sharing, which arises because of differences in risk preferences between principals and agents. To reduce the opportunity for managers to take actions that are detrimental to investors, Jensen and Meckling (1976) identified two ways, namely: outside investors monitoring (monitoring); or the manager himself imposing restrictions on his actions (bonding). Monitoring mechanisms that may be carried out to reduce agency problem in the company include supervision by: (1) the board of commissioners who are independent from the management, (2) the corporate control market through the acquisition process, (3) the manager's market both within the company and in the market, external managers, (4) large shareholders such as financial institutions, and (5) concentrated ownership (Ardiansyah, 2014).

Meanwhile, the procedure commonly used in limiting the actions of managers is between the investor and the manager signing a contract that explains what the manager may do with the funds deposited by the investor and how the profits will be shared between the investor and manager. Ideally, the contract should be as complete as possible to set out what actions the manager can and cannot take in various situations. However, in making a contract, it is sometimes impractical for the parties involved to list all the relevant contingencies. With the endless possibilities that arise, the transaction costs to make a complete contract will be very expensive. Therefore, in practice, most contracts are incomplete. In conditions of incomplete contracts and managerial discretion, a better solution is to provide highly contingent incentive contracts in the long term that can link their interests with those of investors. It can take

various forms, such as share ownership, stock options, threats of dismissal if profits are low, and others. Supervision by outside investors of the actions taken by managers will incur monitoring costs, namely costs that arise due to differences in interests between the principal and the agent so that for their interests, the principal issues incentives, or fees to monitor and limit the agent's activities. Meanwhile, restrictions on the manager's actions (bonding) incur a bonding cost. On the one hand, these two activities will reduce the opportunity for deviations by managers so that the value of the company will increase, while on the other hand, both will generate costs that will reduce the value of the company.

Perrow (as cited in Panda & Leepsa, 2017) criticized positivist agency theory for focusing only on the agent side of the 'principal and agent problem', leading to the development of stewardship theory. Several authors including (Pepper & Gore, 2015; Sanders & Carpenter, 2003; Wiseman & Gomez-Mejia, 1998) proposed behavioural agency theory, which focuses on the association between agency cost and agent performance, theorizes agents as rational, anti-risk/loss takers, and finds a linear relationship between agent performance and motivation. The agency theory, a popular and pragmatic approach, assumes a contractual agreement between principal and agent for uncertain future periods but faces challenges such as information asymmetry, rationality, fraud, and transaction costs. Shareholders' interests are limited to maximising their return, while directors' roles are limited to monitoring managers. The theory also considers managers as opportunistic and ignores their competence. The practical limitations of the theory include information asymmetry, rationality, fraud, transaction cost, and the limited role of directors in the firm.

### **Types of Agency Problem**

The agency problem is a conflict between a firm's principal and agents due to differing goals and interests. It can be categorized into principal-agent (type I), principal-principal (type II), and principal-creditor problems (type III). The relationship between the financier (BMT) and the microenterprise manager (agent) is an important aspect of microenterprise financing because the BMT must ensure that funds are used appropriately and that the intended outcomes are met, which is critical to the operation

and effectiveness of microfinance institutions (Morduch, 1999). BMT institutions, particularly those involved in microenterprise financing, typically have a simpler financial structure, focusing on the direct interaction between the principal (BMT) and the agent (microenterprise manager), as opposed to type II and type III agency problems, which occur in complex financial environments with multiple principals and creditors (Armendáriz & Morduch, 2010). The principal-agent issue is essential in Indonesia, since the success of BMTs is dependent on good monitoring and control of the interaction between the institution and the microenterprise. The research focuses on type I agency issues, providing practical insights and solutions for improving microfinance practices and obtaining better results for microenterprises by investigating the relationship between BMTs and microenterprises (Rhyne, 1998). The study highlights the limitations of analyzing microenterprise financing in BMT institutions, focusing on type II and type III agency problems. These issues are rarely relevant due to the lack of sophisticated financial instruments or main classes. The study excludes these issues due to the nature of microfinance institutions, BMT's specific financial structure, and the relevance of type I agency problems to the local context (Zeller & Meyer, 2002). The study excludes these issues due to the nature of microfinance institutions, BMT's specific financial structure, and the relevance of type I agency problems to the local context. The study excludes these issues due to the nature of microfinance institutions, BMT's specific financial structure, and the relevance of type I agency problems to the local context.

The principal-agent problem arises from information asymmetry and risk-sharing attitudes, while the principal-principal problem arises from conflicts between major and minor shareholders. This problem is common in countries with concentrated ownership, making it difficult for minority shareholders to protect their interests. The principal-creditor problem arises from conflicts between owners and creditors due to projects and financing decisions. Shareholders invest in risky projects, raising finance costs and decreasing outstanding debt value. Understanding these issues can help businesses navigate challenges and opportunities, ensuring smooth operations.

On the other hand, the classical principal-agent problem occurs when an agent takes actions on behalf of the principal, influenced by moral hazards and adverse selection (Guruganesh, Schneider, & Wang, 2021). These issues can lead to

inappropriate actions or biased decisions, such as contract decisions. According to Darrough and Stoughton (1986), agency problem in corporate finance are often caused by market imperfections like unobservable actions, lack of contracting ability, and information asymmetry. These issues lead to second-best outcomes, such as excessive perquisite consumption, overinvestment, underinvestment, and incomplete diversification of personal investment portfolios. Two forms of agency problem can take shape: moral hazard and adverse selection. Moral hazard occurs when an agent's action is unobservable and has a differential value to the agent compared to the principal. Adverse selection problems arise when the agent has more information than the principal. The resolution of these difficulties has been explored using signals and contingent contracting mechanisms. Adverse selection arises when entrepreneurs communicate their attributes through indirect means, selecting their capital structure and retained ownership level. A moral hazard arises when entrepreneurs must combine unobservable effort with outside investment proceeds to produce value shared among claimants. A more detailed explanation regarding this matter will be provided as follows.

#### **a) Adverse Selection**

Adverse selection problems occur when lenders cannot distinguish inherently risky borrowers from safer borrowers. If lenders can differentiate by type of risk, they can charge different interest rates for different types of borrowers. However, with poor information, options are limited. Adverse selection can lead to credit rationing, as lenders charge high interest rates to counter high-risk borrowers. This can generate inefficiencies by removing low-risk borrowers, hindering credit access for capable borrowers and affecting resource allocation. Therefore, it's crucial to address adverse selection.

In principle, group lending with shared responsibility can reduce this inefficiency. It is assumed that the bank introduces a group lending methodology and does not know the characteristics of the borrower. Borrowers, on the other hand, are familiar with one another's personalities. The issue is that banks want to charge lower interest rates for safe borrowers and higher rates for dangerous borrowers, but because

banks cannot determine who is who, everyone must pay the same rate. Safer borrowers who apply for a loan at the current interest rate indirectly support riskier borrowers (which are more expensive for banks to service).

Inefficiencies occur when these implicit subsidies are so significant that safe borrowers quit the market rather than bear the expense, i.e., when the borrower's existence risks boosting interest rates to levels prohibitive for safer borrowers. The question here is whether group lending can allow secured borrowers to be charged lower interest rates implicitly and so retain them in the market. The encouragement of groups to form is critical to the solution; potential borrowers may then use their information to choose the ideal partner. The type of loan arrangement determines how they sort themselves. When faced with the potential of shared obligation for loans, it is obvious that it is preferable to group them with the safe sorts rather than the hazardous types. As a result, when given a choice, the different types of safes tend to cluster together. As a result, at-risk borrowers have little choice but to mix with other sorts of at-risk borrowers, resulting in distinct outcomes known in labour economics as “assortative matching.”

The group lending approach succeeded even though the bank had no idea who was safe and who was in danger, and all clients were given an identical contract. All activities are carried out under conditions of shared accountability and disaggregation procedures. How do different kinds categorise themselves? Because the borrowers are aware of each other's personalities, safe borrowers join up with other safe types, while risk borrowers pair up with other risky kinds (that is, there will be an assortative match in balance). Because of the matching procedure, at-risk borrowers can return their loans more often (due to collective obligation) than if they had simply dealt with the bank as individuals. As a result, the risk is transferred from the bank to the hazardous borrower. In this approach, banks may lower interest rates and entice good safes back into the market. The arrangement's attractiveness is that all borrowers confront the identical contract, but because of assortative matching, riskier types pay more on average. As a result, banks may effectively discriminate against pricing without knowing who is safe and who is dangerous.

## **b) Moral Hazard**

The definition of moral hazard was first created by the insurance industry. Moral hazards are apparent when insured parties participate in actions that raise their odds of being victimised by the risk they are insured against. In other words, moral hazard refers to the propensity of insurance firms to alter their actions in a way that raises claims against the insurance company. Starting in 1968 and 1970, Pauly and Arrow launched a fertile debate that influenced a decade of scholarship in economics on moral hazard. In 1970, Zeckhauser made one of the first attempts to model moral hazards formally on individual health expenses and the consequences of proportional payment systems. A moral hazard problem may arise when individuals engage in risk sharing under conditions such that their private actions influence the probability distribution of the outcome. The root of this moral hazard or motivation problem is the asymmetry of information between individuals that occurs because individual behaviour cannot be monitored and is therefore subject to contraction (Holmstrom, 1979).

Other researchers, Aigner and Chu (1968) described moral hazard as the intangible loss-producing tendency of the person assured or as that which understands all non-physical hazards of risk. Moreover, moral hazard reflects the hazard that arises from the failure of individuals who are or have been affected by insurance to maintain accepted moral qualities or moral hazards, any deviation from correct human behaviour that may pose a problem to the insurer. Patonah (2018) argued that the moral hazard is the behaviour of members who use bank or financial institution funding for something that benefits themselves outside the financing interests agreed with the institution. Moral hazards can occur in all types of financing, including the financing of *mudarabah*. The *mudarabah* financing contract is a financing contract that is most vulnerable to moral hazard because the *mudarabah* agreement gives full power to the financing members to process their funds while running their business. Moral hazard in Sharia Banks, such as what happens in profit sharing schemes (for example, in the *Mudarabah* contract) is a problem that arises when *mudarib* uses the funding it receives not as promised.

In general, moral hazard is a key problem in credit markets. However, because of the lack of collateral and the relatively high expense of monitoring the size of the

loan, this problem is particularly significant in microfinance. There are two forms of moral hazard: ex-ante moral hazard, which is associated with the distinction between high-risk and low-risk borrowers, and ex-post moral hazard, which occurs when borrowers have equal levels of risk but have different results (El-Komi & Croson, 2012). Information sharing can also provide incentives for borrowers to act in line with the interests of banks. Edgcomb, Clark, and Klein (1996) showed that information sharing may motivate borrowers to repay loans when the legal environment makes it difficult for banks to enforce credit contracts. In this model, borrowers repay their loans because they know that defaulters will be blacklisted to reduce external finance in the future. In both models, default is a sign of poor quality for outside banks and carries a penalty for higher interest rates or no future access to credit. In addition, information sharing improves the incentive for borrowers to repay loans and helps to overcome the moral hazard of borrowers (Padilla & Pagano, 1997).

#### - **Ex-Ante Moral Hazard**

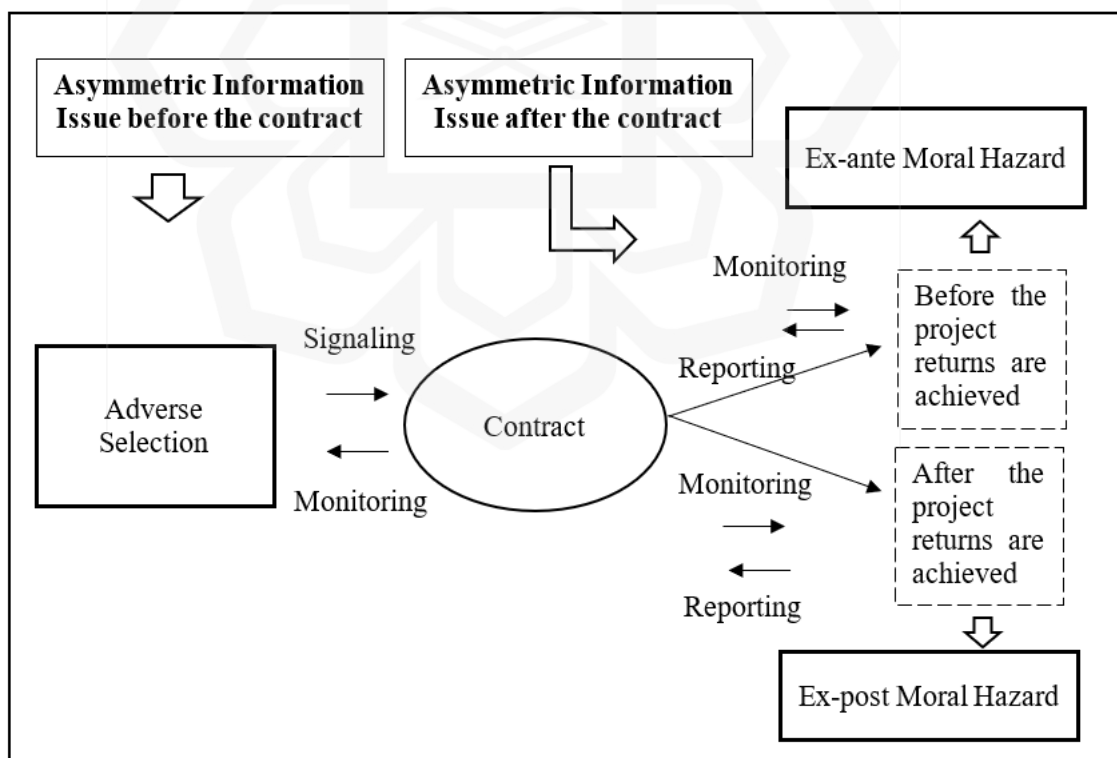
Ex-ante moral hazard refers to the concept that the borrower does unobservable acts or makes efforts after the loan is issued but before the project returns are achieved. This activity has an impact on the likelihood of achieving a good return. Without any assurances, microfinance cannot avoid moral hazard. The problem of "credit allotment" can be overcome if the borrower has personal property to use as collateral since the existence of collateral decreases the "limited liability". Borrowers find it more "expensive" to absorb the risk when collateral is at stake. One of the problems of microfinance is to enhance that lack of collateral and replace it with new alternatives which refer to recently introduced options or solutions, such as a new loan type with better terms introduced by a bank, which are not previously available.

#### - **Ex-Post Moral Hazard**

Another cause of credit market impurity is what is known as "ex-post moral hazard" or "law enforcement difficulties." Ex-post refers to problems that emerge after the loan has been made and the borrower has invested. Even if the processes are followed correctly,

the borrower may choose to “take the money and run” once the project returns are achieved. Situations like these happen when the lender does not completely monitor the borrower's gains (thus allowing the borrower to claim losses and default) or when the lender observes returns but cannot force repayment by the borrower. However, since potential borrowers may quickly relocate and alter identities, the threat may not have much influence; this is another issue for microlenders. According to Soto (2006), strengthening property rights and the judicial system that enforces these rights can be important to impoverished borrowers' capacity to secure loans. Microcredit lowers the incentive barrier here by combining peer monitoring of ex-post returns with the possibility of social sanctions to penalise strategic failure. This raises the quantity of credit accessible.

A more detailed explanation regarding the comparison of the occurrence of adverse selection, Ex-ante moral hazard, and ex-post moral hazard problems can be seen in Figure 3.1:



Source: The Author and various sources (processed by the author)

Figure 3.1 Comparison of the Occurrence of Agency Problem Types

### 3.3 THEORY OF CONTRACT IN ISLAM

#### 3.3.1 Principles of Islamic Business Contracts

An examination of Islamic producers' behaviour must be based on what is regarded as proper behaviour of the Islamic producer with respect to the firm's aims. In an Islamic enterprise, the manufacturing process should be regulated by the golden ethical norms of Sharia, namely: a) Maximization of social benefit of public interest (*maslaha*); and b) The prohibition of doing harm or producing anguish on others (*la zarar va la zihar*) or the reduction of social disutility (*mafsada*). The Islamic producer may reject the current market wage as 'uniform,' and adjust to a higher rate that he considers 'fair' (Siddiqi).

Cooperation and mutual responsibility with labour and capital, as well as with the entrepreneur and capital, will be the firm's driving force. The nature of the contract must pre-determine the rights and duties of the contractual parties. The Islamic company is an organistic actor participating in a 'global' process of interactions (decisions= knowledge flows), integration (social consensus), and creative progress (diversification and growth). The Islamic company, like all other parts of the Islamic political economy, is an agency in the shuratic process that connects with the overall social order. In this approach, the company gets its rules in the substantive meaning of the embalming technique from the assumption of unification epistemology.

The prohibition of all forms of unjustified income is one of Islam's most fundamental principles for promoting justice and preventing exploitation in commercial transactions. Three prohibited contract components that may tempt persons to seek undue enrichment are Maysir, Riba, and Gharar. Riba is a common source of unfair benefit since Sharia does not regard money to be a commodity with a price for its usage. Riba-an-nasiah refers to the period granted to the borrower to repay the loan in exchange for addition (financial increment), whereas riba-al-fadl refers to the transactions of similar items. Gharar arose from the misrepresentation of one or more contract parties due to ignorance. Gharar comes in a variety of forms, all of which are haram. For the sake of fair and open dealing in contracts between parties, Sharia ruled that any unjustifiable enrichment arising from uncertainty or undefined of the key pillars of a contract is banned. The restriction on maysir is based on the notion that an apparent

agreement between the parties is, in fact, the consequence of immoral enticement offered by false hopes in the parties' minds that they would profit disproportionately from the contract.

While the nature of each type of commercial contract differs, the underlying principles of Sharia in relation to them are nearly the same. These fundamental concepts are as follows:

- 1) The terms and conditions of a joint venture contract should be tailored to eliminate any chance of disagreement during business or while sharing profits or carrying losses.
- 2) Business capital should be monetary. If some or all the partners engage in the running of their company, commodity, or property, the worth of their business, commodity, or property should be established in terms of money, and this amount should be considered the partners' contribution.
- 3) The partners in a partnership have the connection of a principal and an agent. Shareholders in joint stock corporations are just co-owners with no agency rights.
- 4) Capital and labour, as well as, in some situations, goodwill and creditworthiness, are jointly accountable for the creation of profits and are jointly liable for a part of the earnings. If only one element is a responsible for-profit generation, it will be the only one eligible for it.
- 5) The partners' rights and obligations are determined by the nature of the joint venture and are generally influenced by tradition, convention, and use. In this regard, the most essential factor for determining the rights and obligations of the partners is the business's interest.
- 6) Rights and obligations go hand in one. As a result, an inactive partner may be barred from binding the business with his promises. The partners would not receive a set return for their work other than a portion of the earnings, but workers would be paid from the business account.
- 7) In a joint venture, productivity and profit are calculated using invested capital. However, labour contributes to productivity and profit. As a result, the proportion of partners' respective shares in capital cannot be used to determine the partners' respective shares in the business's earnings. As a result, the proportion of profits cannot always be proportionate to the

quantity of capital. Although his capital contribution may be smaller than others, the partner who contributes more labour may be entitled to a larger share of earnings.

- 8) A loss occurs when capital fails to increase and declines. Thus, in the event of a loss, failure to pay profits to work partners equates to a loss of labour. Capital losses must be borne only by capital. In this manner, while profit may be divided in accordance with the specified conditions, loss is to be shared by partners in proportion to their interests in business capital.
- 9) The fundamental premise is that earnings go hand in hand with liabilities. Profits would therefore be shared by a partner who is willing to incur a liability. Persons who join a business just to benefit from it without contributing anything to it or taking any obligation are not entitled to profits as a matter of right.
- 10) Profits and risk are inextricably linked. No partner has the right to set aside a predetermined amount of revenue to ensure a certain return for himself. If profits are made, all partners will get a proportionate share of the proceeds. If there are no earnings, no partner will be able to claim any share because of his exclusive right.
- 11) Any loss caused by deliberate carelessness would be compensated by the partner who is accountable for it.
- 12) The partners' culpability would be determined by the nature of the joint venture.

The following summarises the comparison of the distinguishing elements of the unique business contracts.

- 1) According to the nature of the financing, Bai-Salam and Murabahah (mark-up) are debt-based modes of contract since the finance-user is required to repay the total financing, but in mudarabah and musharakah the finance-user pays depending on the profit/loss that he earns from the use of financing.
- 2) In Mudarabah and Bai-salam, the financier has no responsibility for fund management. In the case of Murabahah and Ijarah, the financier has complete control over the funds' utilization.

- 3) In *mudarabah*, the owner of the capital is liable for the entire financial loss of the business, but in *Musharakah*, he is liable for the financial loss in proportion to his capital in the overall investment in the firm. As a result, their capital shares are at risk till the term of business expires. However, with mark-up-based financing, the risk is small for the capital invested until the stage of delivery of products or commodities to the client, after which the financier bears no risk until recovery. In certain countries, such as Bangladesh and Pakistan, a penalty provision is included in mark-up-based contracts if the prescribed instalments are not paid by the clients to the bank within a certain time, which also serves as a risk reducer. This form of mark-up on mark-up is known as a "compensation charge" in Bangladesh and a "kheyanat charge" in Pakistan.
- 4) The uncertainty of the rate of return on capital is quite high in *Mudarabah* and *Musharakah* due to asymmetric knowledge, which produces moral hazard and an adverse selection dilemma. In contrast, in other types of contracts, the rate of return is fixed and pre-determined.

### **3.3.2 Contracts and Islamic Financial Institutions**

IFIs act as financial intermediaries, facilitating the movement of deposits and use of funds through contracts. This is permitted by Sharia, and staff must have the legal capacity and authority to carry out transactions and decisions on behalf of the depositor. The authority given by the depositary is called agency, and the agency contract in Islam is called *wakalah*. In this contract, the agent replaces the principal to carry out actions that recognise representation in accordance with the provisions of each contract. Islamic banking offers significant advantages in corporate finance by enabling optimal risk allocation through the sharing of project profits between capital owners and entrepreneurs. However, these companies also face problems between principals and agents due to asymmetric information and expensive monitoring (Sarker, 1999). Borrowers have inside information about their activities and the likelihood of project success, which banks cannot trust. This leads to adverse selection problems, especially when debt financing is available from competing sources. In addition, borrowers have

incentives not to report or artificially reduce declared profits, resulting in expensive monitoring costs and moral hazard problems (Sarker, 1999).

The views of Imam Hanafi and Imam Syafi'i define agency as someone (principal) who delegates to another person (agent) to take over his position in a position that is known and legally permissible. This allows for permissible agency contracts, which include legitimate Islamic financial transactions that create a relationship between two or more people. The principal (asil) is responsible for carrying out the act, while the agent (wakeel) expresses authority to use other people's assets or property in cooperation. These definitions provide evidence that permissible agency contracts include legitimate Islamic financial transactions that create a relationship between two or more persons. IFIs act as financial intermediaries, facilitating the movement of deposits and the use of funds through contracts. This is permitted by Sharia. When a depositor deposits money in an IFI for investment purposes, the institution carries out transactions on their behalf. The authority given by the depositary is called an agency, and the agency contract in Islam is called wakalah. In this contract, the agent takes the place of the principal to perform acts that recognise representation.

Agency is interpreted from the views of Imam Hanafi and Imam Syafi'i. According to the Hanafi view, wakalah means a person (principal) who delegates to another person (agent) to take over his position in a position that is known and legally permissible. Imam Syafi'i defines wakalah as 'delegation from someone who is still alive to another person for the implementation of an act that allows delegation, and the first person can carry it out themselves. Permissible agency contracts include legitimate Islamic financial transactions that create a relationship between two or more people. The actor (asil) performs the action, while the other person (asil) performs the action. The agent (wakeel) acts on behalf of the principal, with the authority to use other people's assets or property listed in the collaboration.

IFIs offer a range of savings and financing products with unique Sharia compliance characteristics. These products can be equity-based or debt-based, with equity-based financing products including trustee partnerships, joint ventures, and declining joint ventures. Debt-based financing includes murabahah, lease, deferred payment, and delivery sales. These contracts offer Sharia-compliant products with

varying levels of risk acceptance, liquidity, maturity, and stability. The agency's relationship in each contract is different, the agent and principal are also different. The economic activities of IFIs are based on contracts with built-in mechanisms to promote fairness and justice for the contracting parties. The main rules and principles in Islamic contracts include usury, uncertain risk, and gambling. Islamic law is outlined in general theories and various rules and principles in certain contracts, such as renting, buying, selling, and pawning. The contract implemented in Islamic transactions is called 'muamalat' in Sharia.

### **3.4 AGENCY THEORY IN ISLAMIC PERSPECTIVE**

#### **3.4.1 Rationality of Agency Theory in Islamic Perspective**

The nature of the contract in conventional theory shows that there is no aspect of human behaviour with God or faith (Shamsuddin & Ismail, 2013). For example, the object of the contract being transacted has nothing to do with religious beliefs and practices. Meanwhile, the Islamic contract begins with normative human behaviour and then its relationship with God and faith. In other words, in relation to contracts in Islam, Allah SWT is the witness of all contracts. The subject matter and transactions in the contract must be religiously halal, which means they must be in accordance with Divine law stated in the Qur'an and Hadith. This is closely related to the idea of tawhid, or the oneness of God, which is important in the Islamic religion, stating that perfect truth is the foundation of the universe and its ultimate fate is completely in God's hands (Rahman, 1998). This concept is taken from creation, truth, knowledge, life, humanity, revelation, and reason. It is also connected to the caliphate, which implies that humans act as God's agents and deputies when interacting with the cosmos and their environment.

In Islamic teachings, tawhid has an important role as the foundation for the implementation of all activities. Although there are differences in terms used by various authors to clarify the Islamic worldview, there seems to be a consensus regarding what an ideal Islamic society should look like (Willett & Sulaiman, 2003). The concept of Tawhid (Unity) regulates a Muslim's outlook on life, recognising that there is only one God and that humans are accountable only to Him. Additionally, a person's relationships

with others reflect his relationship with God. Both are equally important. The khilafah concept regulates the Islamic social order which is formed based on the principles of justice, equality, and brotherhood. The general theme of Islamic social order is cooperation and deliberation (shura).

The basic principles of agency theory in Islam cannot be separated from the epistemology of tawhid, namely unity, khilafah, and ihsan (Shamsuddin & Ismail, 2013). In this regard, Chapra (1992) contends that self-interest is automatically held in check if every individual fulfils his duties, thus safeguarding the rights of everyone. The principle of tawhid, which emphasises collaboration and involvement in an organization, can be a solution to agency problem. This idea is not found in conventional agency theory and is unique to Islamic teachings, which state that individuals are treated well regardless of skin color, ethnicity, religion, gender, or age. To make the best use of money and act as economic agents in relation to the Oneness of Allah, actors in Islamic-oriented agency relationships must comply with Islamic principles, norms, laws, and regulations. In the concept of the caliphate, Muslims consider themselves to be the caliphs of Allah, who know every human action. The agent in an Islamic agency contract not only protects the principal but also Allah, the Creator and Controller of the Earth. In Islam, the final owner of ownership and society is the economic actor/caliph who can exercise its rights without causing harm to others. Another concept that is in line with the concept of the khilafah is the concept of Ihsan. The Qur'an states:

ذَلِكَ الْفَضْلُ مِنَ اللَّهِ وَكَفَىٰ بِاللَّهِ عَلِيمًا

“Such is the grace of Allah – and no one has the knowledge that Allah has.” (An-Nisa': 70)

Rasulullah SAW said regarding the concept of Ihsan:

“That is, you worship Allah as if you were seeing Him. For even though you do not see him, truly He sees you.”

The need to feel the presence of Allah in all activities is emphasised in the Qur'an and hadith, which reflects the connection to agency theory. This approach reduces information asymmetry that occurs when the principal (muwakkel) does not have access

to all agents (deputies). Both parties believe in the omniscience of Allah and the responsibility of charity in the afterlife. Therefore, every action and decision must be consistent with a well-established agency contract. They also have a spiritual relationship with God and are aware of the consequences of failing to carry out their commitments. Implementing this principle in an organization reduces monitoring and control costs, thereby effectively reducing an institution's monitoring and control costs to zero. When compared with the agency theory conception, this concept provides unique value. Islamic Finance improves agency relationships by including moral and ethical elements, using PLS-based contracts, reducing information asymmetry, and having a Sharia-based supervisory board (SSB). This ensures that stakeholder interests are protected, commercial and social aspects are balanced, and transactions are approved based on Sharia principles. The principal is considered a guardian, reducing greed and excessive commercialization. Agent performance is measured based on commercial success and compliance with Sharia rules, thereby reducing the pressure to guarantee commercial success.

In an agency relationship, representatives, especially those who practice Islamic ethics, are obliged to fulfil their obligations honestly. This includes not investing principal assets in non-Sharia or gharar investments, even if there is an opportunity. This reduces agency problem such as lies, negligence, and opportunistic efforts between principals and agents. A principal should hand over administrative power to his agent who is competent and able to carry out his duties and mandate well. *Taklif*, or personal responsibility, is very important for agents who believe in Islamic ethics. *Taklif* means that every person in the corporation is responsible and accountable for accepting tasks, risks, and rewards. They believe in ultimate accountability by God. If decisions are made solely in their interests, then they violate their obligations. This relationship differs from conventional agency contracts, which focus on fulfilling obligations with expectations of human needs, dignity, and humanity.

Islamic agency contracts require both parties to provide the highest level of participation and cooperation, limited by Sharia rules, to achieve the organization's primary objectives. A representative may not cause losses in carrying out a task, especially if it is charged to the principal (muwakkil). A Muslim must treat others fairly, except non-Muslims who are at war with Muslims. Muslims must not show carelessness

through actions or words that could cause harm or suffering to others. Relationships in Islamic agency theory aim to work together, improve, and strengthen relationships between members, with a focus on building a good relationship with God. This principle of faith in Islam guides Muslims in achieving success and forming appropriate long-term agency relationships.

In agency contracts, conflicts between the agent and the principal can arise when they prioritise their interests. To overcome this problem, the principle of shura or deliberation is used. Both parties must practice open-mindedness, respect, trust, and acceptance of differences. This principle ensures justice, protects interests, and avoids arrogance and ego. Any misunderstandings should be consulted with a mutual agreement in accordance with Sharia rules. The Qur'an emphasises the importance of submitting differences of opinion to Allah and His Messenger to obtain the best and fairest resolution possible. The principal must fulfil his obligations by providing appropriate compensation to his agent, while the agent must work sincerely to achieve organizational goals and God's grace. If the agent is not satisfied with the compensation, they can negotiate. Islamic agency theory emphasises respect, gratitude, patience, tolerance, and spiritual rewards. It provides ongoing Islamic teachings and training to members, emphasising knowledge, individual development, and ethical practices within the organization.

### **3.4.2 Contract Theory in Islam in Relation to Agency Theory**

The formation of contracts is essential for legal meaning and ensures guidance for parties involved in conventional and Islamic financial transactions. A formal contract is a written, legally binding agreement that represents premises, responsibilities, and obligations. However, these relationships can create asymmetric information, where some parties may withhold private information about future transactions. In real situations, explicit contracts may be incomplete, resulting in potential losses. According to Sarker (1999), the term “agency” refers to the mechanism used to manage a company or production business, which is regulated by contracts and agency fees. The relationship between remuneration and productivity influences company growth and agency behaviour. However, economists now focus on the contracting process, recognising its risks and pitfalls, rather than a world of complete, frictionless

information. Contract theory in Islam provides complete basic procedures for contractual transactions between parties, whereas conventional contracts may be incomplete due to asymmetric information. Therefore, contracts are an important instrument to ensure legal transactions.

In an Islamic perspective, the source of Islamic contract law is stated in verse Al-Maidah 5:1, namely:

يَا أَيُّهَا الَّذِينَ ءَامَنُوا أَوْفُوا بِالْعُقُودِ

“O believers! Honour your obligations.” (Qur’an surah Al-Maidah:1)

In the verse above, there is a command addressed to believers to fulfil their promises. It is explained that each party in the transaction, both principal and agent, is to maintain and be responsible for the promise or contract that has been agreed upon by each party. In Ibn Kathir's interpretation, it is stated that the meaning of the word 'uqud is the plural of the word 'aqd which means agreement, namely anything that is usually included in an agreement, namely promises regarding things that are permitted by Allah SWT. and the things that He has forbidden and the things that He has made fardh to do and the limitations (laws) contained in the entire Qur'an. In other words, Allah at the same time commands not to commit betrayal and not to violate the things that have been stated in the agreement. This command is strengthened by the consequences of violating the agreement, namely retribution in the form of a bad residence, namely Hell Jahannam (QS. Ar Ra'd: 25). Zaid bin Aslam in Tafsir ibn Kathir explains the meaning of the agreement in QS. Al Maidah: 1 includes agreements with Allah as well as agreements between humans, including mu'malah transactions, namely shirkah transactions and buying and selling transactions. A contract ('aqd) in Islamic law is a promise or agreement between parties to fulfil their obligations as mentioned in the paragraph above.

To form a valid Islamic contract, there must be two elements, namely (a) voluntary agreement from the competent parties to the contract and (b) the agreement is for a halal object or purpose. In the Qur'an through the letter An-Nisa: 29, it is emphasised:

يَا أَيُّهَا الَّذِينَ ءَامَنُوا لَا تَأْكُلُوا أَمْوَالِكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَن  
عَرَاضٍ مِّنْكُمْ

“O you who believe, do not consume the wealth among yourselves in a false way, except by trading on the basis of likes and likes.”

The verse above explains the prohibition on believers from consuming the wealth of some of them over others in false ways, namely through efforts that are not recognised by the Sharia, such as usury, gambling, and deception. Furthermore, Allah mentions the command to carry out commercial transactions according to the regulations recognised by the Sharia, namely trading carried out because of likes and mutual consent between the buyer and the seller. Thus, Aqd is a form that binds two intentions expressed through words or otherwise and produces obligations for both parties. A contract is an instrument or mechanism used to ensure that a transaction between parties becomes halal. Therefore, every condition, obligation, or purpose of the transaction is the responsibility of the parties involved in the contract. The Islamic term for contract 'aqd' seems to be equivalent to the term 'contract' among Western jurists, which consists of two important elements, namely agreement and consideration. However, the Islamic concept of 'aqd' requires the intention to perform obligations and transfer ownership to another person. Usually used in muamalat transactions to transfer one person's ownership or ownership to another person.

Agency contracts in classical Islamic literature are called wakalah. In terms of language, wakalah is defined as al-hifdz (protection), at tafwid (submission), and delegation or giving a mandate. According to Sharia terms, wakalah is defined as a representative agreement between two parties, where the first party represents one or several matters to the second party to act for and on behalf of and represent the first party in terms of representation permitted by Sharia. Wakalah according to the terms of the ulama is the delegation of power or authority by someone to another person in certain matters which can be represented in a certain contract as well. The delegation of power is carried out by the first party to another person as the second party carries out an action based on the power or authority given by the first party. However, if the power of attorney has been exercised by the recipient of the power of attorney (representative)

in accordance with the specified conditions, then all risks and responsibilities completely return to the person giving the power of attorney.

The original law of wakalah is that it is permissible. However, sometimes the law can be sunnah or makruh following the law of something that is implied. Wakalah law can also be obligatory if it prevents loss or danger from the muwakkil. Wakalah activities are mentioned in QS. Al Kahf: 19 namely:

فَابْعَثُوا أَحَدَكُمْ بِوَرِقِكُمْ هَذِهِ إِلَى الْمَدِينَةِ فَلْيَنْظُرْ أَيُّهَا أَزْكَى طَعَامًا فَلْيَأْتِكُمْ  
بِرِزْقٍ مِنْهُ وَلْيَتَلَطَّفْ وَلَا يُشْعِرَنَّ بِكُمْ أَحَدًا

“... So, send one of you with these silver coins of yours to the city, and let him find which food is the purest, and then bring you provisions from it. Let him be ‘exceptionally’ cautiously, and don't let him give you away.”

Representative activities are also mentioned in the hadith of the Prophet SAW. that is:

“Urwah al-Bariqi narrated that the Prophet gave him one dinar to buy a sacrificial lamb. He bought two sheep with it and sold one of them for a dinar on the street. He said: When I brought a dinar and a sheep to the Prophet, he said to me, 'May Allah bless the bargaining of your right hand. (every transaction of his buying and selling)’”

"From Jabir ra., he said, that the prophet saw. slaughtered 63 animals as sacrifices and Ali ra. ordered to slaughter sacrificial animals that have not been slaughtered."

These verses and two hadiths show that a person can hand over his affairs to an agent so that the agent can carry out and act on his behalf. However, agency contracts are subject to regulations like Islamic contracts, with certain authority limitations. As a principal (muwakeel), the principal is obliged to hand over all his authority to the appointed agent. Unreasonable and minor principles cannot be part of any agency contract. Minors may appoint agents for performance that may benefit them but not for transactions that result in loss to the minor. The agent can carry out his actions but is

limited by the general rules set by the principal. The Hanafi, Hanbali and Syafi'i schools explain that agents do not have the authority to dispose of the principal's assets (subjects) and minors do not have the right to act as agents for other people to act on the performance. appointed by the agent. The agent must be informed of his or her performance limitations, the disposition must be valid and authorised by the principal, and the deed must be witnessed. In conclusion, even though the verses and hadith prove that a person can hand over his affairs to an agent, the agency contract still has certain regulations and limitations.

The potential for agency conflicts in every cooperation agreement is found in the Qur'an in Surah Saad verse 24, namely:

قَالَ لَقَدْ ظَلَمَكَ بِسُؤَالِ نَعَجْتِكَ إِلَىٰ نِعَاجِهِ ۗ وَإِنَّ كَثِيرًا مِّنَ  
 الْخُلَطَاءِ لِيَبْغِيَ بَعْضُهُمْ عَلَىٰ بَعْضٍ إِلَّا الَّذِينَ آمَنُوا  
 وَعَمِلُوا الصَّالِحَاتِ وَقَلِيلٌ مَّا هُمْ ۗ وَظَنَّ دَاوُدُ أَنَّمَا فَتَنَّاهُ  
 فَاسْتَغْفَرَ رَبَّهُ وَخَرَّ رَاكِعًا وَأَنَابَ

“David said: “Indeed he has wronged you by asking your goat to be added to his goat. And indeed, most of those who are in association some of them do wrong to others, except those who believe and do righteous deeds; and there are very few of them.” And David knew that We tested him; So, he asked forgiveness from his Lord and bowed down and repented.” (Qur'an Surah Saad: 24)

The verse above describes the human tendency to be unfair and maximise self-interest (self-maximization) in a cooperative effort (Syarifuddin & Abdullah, 2019). This verse proves the problem that exists in agency conflicts. Departing from the basis of the Qur'an related to agency problem, by incorporating altruistic values in modern management, Syarifuddin (2019) offer a model for mitigating deviant behaviour from both parties (principal and agent) which often occurs in agency problem.

Another verse discusses the need for a clear contract in muamalah transactions, namely the Qur'an Surah Al-Baqarah verse 22:

يَأْتِيهَا الَّذِينَ ءَامَنُوا إِذَا تَدَايَيْتُمْ بِدَيْنٍ إِلَىٰ أَجَلٍ مُّسَمًّى فَاكْتُبُوهُ ۚ وَلْيَكْتُب بَيْنَكُمْ كَاتِبٌ بِالْعَدْلِ ۚ وَلَا يَأْب كَاتِبٌ أَنْ يَكْتُبَ كَمَا عَلَّمَهُ اللَّهُ ۚ فَلْيَكْتُبْ وَلْيُمْلِلِ الَّذِي عَلَيْهِ الْحَقُّ وَلْيَتَّقِ اللَّهَ رَبَّهُ ۚ وَلَا يَبْحَسْ مِنْهُ شَيْئًا ۚ فَإِنْ كَانَ الَّذِي عَلَيْهِ الْحَقُّ سَفِيهًا أَوْ ضَعِيفًا أَوْ لَا يَسْتَطِيعُ أَنْ يُمْلَءَ هُوَ فَلْيُمْلِلْ وَلِيُّهُ بِالْعَدْلِ ۚ وَاسْتَشْهِدُوا شَهِيدَيْنِ مِنْ رِجَالِكُمْ ۚ فَإِنْ لَمْ يَكُونَا رَجُلَيْنِ فَرَجُلٌ وَامْرَأَتَانِ مِمَّن تَرْضَوْنَ مِنَ الشُّهَدَاءِ أَنْ تَضِلَّ إِحْدَاهُمَا فَتُذَكِّرَ إِحْدَاهُمَا الْأُخْرَىٰ ۚ وَلَا يَأْب الشُّهَدَاءُ إِذَا مَا دُعُوا ۚ وَلَا تَسْمَعُوا أَنْ تُكْتَبَ صَغِيرًا أَوْ كَبِيرًا إِلَىٰ أَجَلِهِ ۚ ذَٰلِكُمْ أَقْسَطُ عِنْدَ اللَّهِ وَأَقْوَمُ لِلشَّهَادَةِ وَأَدْنَىٰ أَلَّا تَرْتَابُوا ۚ إِلَّا أَنْ تَكُونَ تِجَارَةً حَاضِرَةً تُدِيرُوهَا بَيْنَكُمْ فَلَيْسَ عَلَيْكُمْ جُنَاحٌ أَلَّا تَكْتُبُوهَا وَأَشْهِدُوا إِذَا تَبَايَعْتُمْ ۚ وَلَا يُضَارَّ كَاتِبٌ وَلَا شَهِيدٌ ۚ وَإِنْ تَفَعَّلُوا فَإِنَّهُ فُسُوقٌ بِكُمْ ۚ وَاتَّقُوا اللَّهَ ۚ وَاعْلَمُوا أَنَّ اللَّهَ بِكُلِّ شَيْءٍ عَلِيمٌ

“O believers! When you contract a loan for a fixed period, commit it to writing. Let the scribe maintain justice between the parties. The scribe should not refuse to write as Allah has taught them to write. They will write what the debtor dictates, bearing Allah in mind and not defrauding the debt. If the debtor is incompetent, weak, or unable to dictate, let their guardian dictate for them with justice. Call upon two of your men to witness. If two men cannot be found, then one man and two women of your choice will witness—so if one of the women forgets the other may remind her.<sup>1</sup> The witnesses must not refuse when they are summoned. You must not be against writing ‘contracts’ for a fixed period—whether the sum is small or great. This is more just ‘for you’ in the sight of Allah, and more convenient to establish evidence and remove doubts. However, if you conduct an immediate transaction among yourselves, then there is no need for you to record it but call upon witnesses when a deal is finalised. Let no harm come to the scribe or witnesses. If you do, then you have gravely exceeded ‘your limits’. Be mindful of Allah, for Allah ‘is the One Who’ teaches you. And Allah has ‘perfect’ knowledge of all things.” (Qur’an Surah Al-Baqarah: 282).

This verse of the Qur’an explains the need for clarity on the contract in the relationship between the principal and agent, which is realised through the recording of transactions made. The verse also explains the main principles that need to be followed when transacting in a contract, namely:

- 1) Every contract should be written by a writer who is able to write it correctly and each party should always fear Allah, who knows everything.
- 2) In every condition that may occur, Islam requires the fulfilment of the conditions in the contract and each party should understand the transaction carried out.
- 3) The need for witnesses with certain criteria and tasks to maintain the implementation of the contract.

In another verse of the Qur'an, Allah SWT also conveys more firmly regarding the fulfilment of the promises that have been made, namely in the Qur'an Surah Al-Isra verse 34:

وَأَوْفُوا بِالْعَهْدِ إِنَّ الْعَهْدَ كَانَ مَسْئُولًا

“Honour ‘your’ pledges, for you will surely be accountable for them.”  
(Qur'an surah Al-Isra': 34)

In this verse of the Qur'an, it is explained how Islam emphasises the need for each party in a contract to work together to maintain their respective beliefs and mandates. This is because every promise will be held accountable by Allah SWT. Islam places great emphasis on the importance of the Amanah concept with great consequences in the form of accountability for any given Amanah. In cooperative activities, Islam views partnership relationships such as brotherhood and sharing as a form of the implication of “hablun min Allah and hablun min nas.” This is as explained in the Qur'an Surah Al-Anfal verse 27, namely:

يَا أَيُّهَا الَّذِينَ ءَامَنُوا لَا تَخُونُوا اللَّهَ وَالرَّسُولَ وَتَخُونُوا أَمْنِيكُمْ وَأَنْتُمْ تَعْلَمُونَ

“O believers! Do not betray Allah and the Messenger, nor betray your trusts knowingly.” (Qur'an surah Al-Anfal: 27)

Regarding how the affirmation of Islam views fraudulent behaviour that violates humanity, it is explained in the Qur'an Surah Al-A'raf verse 85, namely:

فَأَوْفُوا الْكَيْلَ وَالْمِيزَانَ وَلَا تَبْخَسُوا النَّاسَ أَشْيَاءَهُمْ وَلَا تُفْسِدُوا فِي الْأَرْضِ بَعْدَ  
إِصْلَاحِهَا ۚ ذَلِكُمْ خَيْرٌ لَّكُمْ إِنْ كُنْتُمْ مُؤْمِنِينَ

“... So, give just measure and weight, do not defraud people of their property, nor spread corruption in the land after it has been set in order. This is for your own good if you are ‘truly’ believers.” (Qur'an surah Al-A'raf: 85)

In the context of cheating behaviour in contracts, it has also been explained in the Qur'an Surah Al-Mutafifin verses 1-3, namely:

وَيْلٌ لِّلْمُطَفِّفِينَ ۚ  
الَّذِينَ إِذَا أَكْتَالُوا عَلَى النَّاسِ يَسْتَوْفُونَ ۚ  
وَإِذَا كَالُوهُمْ أَوْ  
وَزَنُوهُمْ يُخْسِرُونَ ۝ ٣

“Woe to the defrauders! Those who take full measure ‘when they buy’ from people but give less when they measure or weigh for buyers.”

In this verse of the Qur'an, it is explained how Islam denounces fraudulent actors in buying and selling activities as an unfair act in a contract/transaction.

Regarding compensation for people who are committed to keeping the contract, Allah explains this in the Qur'an Surah Ali Imran verse 76, namely:

بَلَىٰ مَنْ أَوْفَىٰ بِعَهْدِهِ وَاتَّقَىٰ فَإِنَّ اللَّهَ يُحِبُّ الْمُتَّقِينَ

“Absolutely! Those who honour their trusts and shun evil—surely Allah loves those who are mindful ‘of Him’.”

In this verse of the Qur'an, Allah SWT explains the highest compensation from the consistency and commitment of each party in the contract, namely in the form of the pleasure of Allah SWT.

The agency relationship is not only explained in the Qur'an but in several hadiths, there are also explanations that indicate this, including:

The words of the Messenger of Allah mentioned in the Nasa'i Hadith (no 4463):

أَخْبَرَنِي مُحَمَّدُ بْنُ قُدَّامَةَ، عَنْ جَرِيرٍ، عَنْ مَنْصُورٍ، عَنْ أَبِي وَائِلٍ، عَنْ قَيْسِ بْنِ أَبِي غَزَزَةَ، قَالَ كُنَّا بِالْمَدِينَةِ نَبِيعُ الْأَوْسَاقِ وَنَبْتَاعُهَا وَنُسَمِّي أَنْفُسَنَا السَّمَّاسِرَةَ وَيُسَمِّيْنَا النَّاسُ فَخَرَجَ إِلَيْنَا رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ فَسَمَّانَا بِاسْمٍ هُوَ خَيْرٌ لَنَا مِنَ الَّذِي سَمَّيْنَا بِهِ أَنْفُسَنَا فَقَالَ " يَا مَعْشَرَ التُّجَّارِ إِنَّهُ يَشْهَدُ بِبَيْعِكُمُ الْحَلْفُ وَاللَّغْوُ فَشُوبُوهُ بِالصَّدَقَةِ".

“It was narrated that Qays bin Abi Gharazah said: “We used to trade in the markets of Al-Madinah, and we used to call ourselves as-Samasir (brokers) and the people called us that, but the Messenger of Allah came out to us and called us by a name that was better than what we called ourselves. He said: “O merchants (Tujjar)! Selling involves (false) oaths and idle talk, so mix some charity with it,” (Sahih)”

In the hadith it is explained that buying and selling activities in the market are synonymous with many useless oaths/promises and words/actions, therefore the Messenger of Allah ordered to mix buying and selling activities with alms as a form of being careful about the act of oppressing other parties to get the pleasure of Allah SWT.

In another hadith, the Prophet SAW. explained the importance of setting the right goals before the contract, namely in Sahih al Bukhari 1:

حَدَّثَنَا الْحُمَيْدِيُّ عَبْدُ اللَّهِ بْنُ الزُّبَيْرِ ، قَالَ : حَدَّثَنَا سُفْيَانُ ، قَالَ : حَدَّثَنَا يَحْيَى بْنُ سَعِيدٍ الْأَنْصَارِيُّ ، قَالَ : أَخْبَرَنِي مُحَمَّدُ بْنُ إِبْرَاهِيمَ التَّمِيمِيُّ ، أَنَّهُ سَمِعَ عَلْقَمَةَ بْنَ وَقَّاصِ اللَّيْثِيِّ ، يَقُولُ : سَمِعْتُ عُمَرَ بْنَ الْخَطَّابِ رَضِيَ اللَّهُ عَنْهُ عَلَى الْمِنْبَرِ ، قَالَ : سَمِعْتُ رَسُولَ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ ، يَقُولُ : " إِنَّمَا الْأَعْمَالُ بِالنِّيَّاتِ ، وَإِنَّمَا لِكُلِّ امْرِئٍ مَا نَوَى ، فَمَنْ كَانَتْ هِجْرَتُهُ إِلَى دُنْيَا يُصِيبُهَا أَوْ إِلَى امْرَأَةٍ يَنْكِحُهَا ، فَهَجْرَتُهُ إِلَى مَا هَاجَرَ إِلَيْهِ "

“Narrated ‘Umar bin Al-Khattab: I heard Allah’s Messenger (ﷺ) saying, “The reward of deeds depends upon the intentions and every person will get the reward according to what he has intended. So, whoever emigrated for worldly benefits or for a woman to marry, his emigration was for what he emigrated for.”

The hadith explains the importance of goal setting in every activity. This is because all activities carried out will be assessed from the initial purpose of the activity. In buying and selling activities, each party needs to clear his intention/purpose in the transaction.

Regarding the mitigation of agency problem, Uzaimi (2017) explained that there are several things that both parties must possess in carrying out a contract agreement, namely a) prioritising tawakkal over lust, and secondly having good morals. In business, we are always faced with mathematical problems of profit and loss which involve calculating profit and loss, assessing losses, forecasting future financial performance, and budgeting. Accurate calculations and analysis are crucial for making informed decisions and maintaining financial health efficiently. These processes involve evaluating profit after accounting for expenses and revenues, analyzing losses, and allocating resources for maximum efficiency and profitability.

In this case, what must be believed is that muamalah in Islam is not a matter of profit and loss, but rather to live the law of Allah and seek the pleasure of Allah SWT (Quran Surah Az Zumar: 52; Al-A’raf: 96; & Al Maidah: 2). In these three verses, it is implied that it is important for the owner and agent to have an attitude of trust (relying) on Allah for the efforts made together after fulfilling their responsibilities together as much as possible. Both the owner and the agent are God’s “workers”, and that earnest joint effort is one thing we leave for God, while sustenance is another thing which is God’s right to determine it. The next thing that is very important for principals and agents to cooperate is good morals. Aisyah r.a. said that ten things include the noblest character. This case sometimes exists in the child but not in the father. This matter is in the servant’s self but not in his master. This matter is a gift from Allah ta’ala, and Allah ta’ala grants it to whomever He wills, namely 1) speaking the truth, 2) being honest with others, 3) giving to beggars, 4) repaying kindness, 5) Connecting the ropes of friendship, 6) Keeping the trust, 7) Fulfilling the rights of neighbours, 8) Fulfilling the

rights of friends, 9) Fulfilling the rights of guests, 10) and the mother of all of that is shame (Zakariyya as cited in Uzaimi, 2017).

In the realm of practice, Ardiansyah (2014) examined whether agency problem also underlie the behaviour between customers as agents and Islamic banks as principals in financing contracts. By using a holistic paradigm, which combines Islamic values and conventional theory, the study found two conclusions, namely, a) The agency problem in the Sharia banking product scheme is due to asymmetric information between the agent and the principal. Strict procedures and higher criteria cause the number of Sharia bank *mudharabah* financing contracts to not reach the optimal level. b) Agency problem that occur in Islamic banks can be solved by optimising the profit-sharing ratio which aims to determine the character of the customer. The optimal profit-sharing ratio can reduce moral hazard problems because customers must be able to run their business with the maximum level of effort and be able to maximise the income generated in accordance with the expectations of the bank and customers. If the profit-sharing scheme is not optimal, it will cause suspicion of the Bank, thus, the bank will increase its control, and it will directly have an impact on increasing monitoring and verification costs. On the other hand, Roziq (2020) tried to reveal the problems of the profit-sharing system and its problems with Islamic banks in Indonesia. By using a qualitative approach and *kasyif* analysis it was found that the agency problem exist in the scheme of banking products.

The majority of Islamic law experts Maliki, Syafi'i and Hanbali agree that there are three basic elements of a contract, namely: 1) Offer and acceptance (*ijab qabul*), 2) object of the contract, and 3) contractual capacity of the parties. An offer is a proposal by one party to carry out a transaction with another party, while acceptance is a statement by the second party that the offer is accepted. The principle of the agreement is determined at the time of the agreement. The ability to articulate words and discharge responsibilities is referred to as contractual capacity, and the parties must be able to carry out their duties and make reasonable judgments. Islamic contract law focuses on the fulfilment of certain elements to determine its validity and permissibility according to Sharia. Contracts can be classified into three categories: unilateral contracts, bilateral contracts, and quasi-contracts. Unilateral contracts are binding between parties, while bilateral contracts require one party to make an offer to accept the intent and principle

of the contract. Meanwhile, quasi contracts do not originate from valid verbal agreements but are based on Sharia principles. Both parties must acknowledge their agreement and fulfil their obligations, as stated in the Qur'an.

Dar (2007) believed that Sharia financing modes are classified into fixed returns (murabahah, ijarah, salam, istisna) and variable returns (mudharabah and musharakah). The fixed yield mode offers residual control and management rights to the user, thereby enabling IFIs to offer financing under these contracts. These incentives encourage users to maximise their economic interests and minimize payment defaults. Various modes of return, such as mudharabah and musharakah, have residual financial rights but can give rise to moral hazards and adverse selection problems. The mudharabah contract favours the user over the capital provider, causing an imbalance in management and control functions.

Few contracts offer as much potential for growth and adaptation as Islamic microfinance schemes (Rahman, 2010; Khan & Phillips, 2010). These Islamic microfinance schemes include Mudharabah, Musharakah, Murabahah, Ijarah, and Qardhul Hasan. Mudharabah is a profit-sharing agreement where a financial agent provides cash to an entrepreneur for investment in an economic activity. Mudharabah can be simple or bilateral, where the supplier bears the financial loss. Muzara'ah is an agricultural mudharabah contract where a microfinance institution provides lending or cash capital in exchange for a share of the harvest. Musharakah is a classic joint venture that combines partnership and mudharabah, with payment terms based on a pre-agreed term. Murabahah is a sales contract for short-term funding purposes. Ijarah is a loan contract used to finance cars, machinery, and equipment, like leasing. This allows entrepreneurs with limited funds to acquire productive assets by approaching financiers. The Qur'an encourages Muslims to make charitable loans, and some Islamic lenders limit these loans to current customers or poor or vulnerable individuals (Khan & Phillips, 2010). Agency problem in Islam refers to all problems arising from the agency contract between the two parties, namely in the form of non-fulfilment of the terms and conditions of the contract or violation of the terms of the contract for either one or both parties.

### **3.4.3 Agency Issues in Islamic Contract Modes**

#### **3.4.3.1 Agency problem in Islamic Microfinance Institutions**

The word ‘Agency’ implies the conductive mechanism by which a manufacturing firm or a business enterprise is controlled or conducted. Essentially, the agency function is tied to and regulated by the contract modalities. Agency fees are a consideration in all types of contracts. The divergence of interests and information asymmetry between principal and agent may lead production to be dependent on the type of compensation contract. According to several theories of agency, the relationship between pay and productivity impacts the evolution of the firm and the behaviour of the agency. However, economists have realised that the ‘Arrow-Debreu ideal’ or ‘more-or-less frictionless world of complete information, perfect foresight, and castles transacting’ is insufficient to accommodate several important economic phenomena, prompting them to focus on ‘the process of contracting’—particularly its hazards and imperfections.

Principal-agent models examine situations in which knowledge is unequally or ‘asymmetrically’ dispersed across contracting parties with potentially conflicting interests. Adverse selection and moral hazard develop when the “principal” cannot costless inspect or monitor the agent’s traits and/or behaviour prior to the contract. The effectiveness of future cooperation tactics is determined by how far each party calculates that it is in their self-interest not to breach or ‘defect’ from the agreement, given the expected behaviour and response of the other. The agency problem is a key driver of re-awarding-sharing in a production process that can be handled by achieving efficiency in resource allocation and arranging a package of incentives in a reward-sharing structure that maximises the principal’s utility. The issue has resulted in various contract ideas or structures such as ‘piece-work contracts’ or ‘share-cropping contracts’ (in the context of post-Cassian, neo-classical accounts of the firm).

An Islamic bank would confront challenges because of ex-ante knowledge limits about project quality. Borrowers have inside information about their activities and the possibility of success of their projects that cannot be honestly communicated to the bank because every PLS applicant will pretend to be of the best quality. The difficulty of banks in identifying the quality of loan applicants causes a variety of adverse selection concerns. The principal-agent dilemma can be handled in the Islamic banking system

because the agent may be induced to act honestly if a reward is connected to cooperation. Honest businesses will drive dishonest entrepreneurs out of the market if all financial activities are based on sharing. There is also a financial incentive to be truthful (Bashir, 1990). Long-standing bank-borrower ties might boost PLS banking efficiency in various ways. Islamic banks can engage in projects with young entrepreneurs and progressively transfer their sole ownership in *mudarabah* and a portion or all their ownership in *musharakah*. This redeemable method might provide an incentive for Islamic banks to alleviate their moral hazard problem.

In the agency theory, Jensen and Meckling (1976) discussed how the form of ownership influences the conduct of individuals inside a corporation. The corporation is a legal partner that serves as a contractual connection between people. As a contract mechanism between the principal and the agents, the contractual connection between the two people is an agency relationship. These contractual relationships are formed when the principal instructs the agent to act on his or her behalf. Jensen and Meckling's (1976) description of the agency relationship is comparable to the *Shahibul Maal* and *Mudarib* partnership in *mudarabah* financing at an IFI (Islamic bank). Muhammad (2010) showed how the principal-agent connection in the financing of a Sharia bank may be implemented in the form of the *mudarabah* financing contract agreement, which is the contract between the capital owner (principal) and the business actor (agent). Sadr and Iqbal in Jasmin et al. (2018) argued that when Islamic banks construct an investment contract, whether it is a *mudarabah* contract or a *musharakah* contract, the Sharia bank would be confronted with an asymmetric information project with an unfavourable selection level and significant moral hazard.

According to Muhammad (2010) the *mudarabah* contract, which is performed by a Sharia bank, is a contract with a high risk of inaccurate information arising if one of the dishonest parties is present. In other words, when the *mudarabah* contract model is laden with faulty information in the connection between the principal (*sahibul mal*) and the agent (*mudarib*), the problem of asymmetric information occurs. Asymmetric information is a condition in which some investors have information while others do not. Asymmetric information may be classified into two types: hidden action and hidden information. Hidden action causes moral hazard, while hidden information causes adverse selection. According to Sadr and Iqbal in Jasmin et al. (2018), moral hazard and

adverse selection occur in debt contracts when the borrower has an unfavourable quality of financing beyond the limits of certain profit-level conditions, and moral hazard is associated with engaging in irregular activities or posing a greater risk in the contract. According to Bashir in Jasmin et al. (2018), when the production process begins in mudarabah contracts, the agent demonstrates excellent ethics for the activities to be agreed upon. After some time, Mudarib engages in irregular activities, especially those that cannot be monitored (moral hazard) and commercial ethics that cannot be observed. In mudarabah financing, asymmetric information that occurs can be in the form of adverse selection and moral hazard. Adverse selection problems can occur before the mudarabah financing contract runs out. Meanwhile, moral hazard problems will occur when the mudarabah financing contract has taken place.

As explained by Multifiah, Manzilati, and Hurriati (2015), adverse selection occurs when capital providers do not know for sure the character of their prospective customers. This happens when selecting customers who want to apply for financing using a mudarabah contract. The assessment is only based on when the customer uses other financing, such as murabahah financing. In murabahah financing, the customer behaves well, such as paying instalments on time, so that the institution judges that the customer can be trusted. Adverse selection problems can also be in the form of customer manipulation of company information by customers, namely an action taken by customers by displaying financial data that seems to be in good condition, with large assets, debt, and capital ratios that are also good. This can be proven by the bank by conducting a direct survey in the field so that the truth about the information from the customer can be seen.

Another adverse selection problem is the difficulty of knowing the true character of the customer's personality and the customer's ability to manage the funds that will be provided by the bank. In selecting productive financing with mudarabah contracts, the bank only relies on verifying information about the personal data of prospective customers that it makes, which is not enough to reveal the true character and abilities of accurate mudarabah financing customers because only the customers themselves know the actual conditions of the loan. Therefore, banks sometimes find it difficult to obtain accurate information about the character and company information documents from prospective mudarabah financing customers. Another problem that must be faced by

banks is an error in analysing the ability of mudarabah financing customers. Where the purpose of the analysis itself is to determine the condition of the customer's business, one of which is, from a financial perspective, to determine the appropriate and reasonable amount of financing, as well as to determine the customer's ability to pay back the financing. Asymmetric information causes an error in the analysis of the proposer of mudarabah financing. If the error in analysing is not realised by the bank, then the next stages of mudarabah financing will experience errors as well.

Apart from adverse selection problems, banks are also faced with moral hazard problems. A moral hazard is a type of asymmetric information in the form of an action. A "moral hazard" or "bad behaviour" is an action by a customer that will cause harm to both the customer and others. Moral hazard problems will occur when mudarabah financing has been running and the customer has received financing from the bank. The causes of the emergence of moral hazard are asymmetric information, the low quality of the customer's character, and the limited scope of the contract contents, which makes it easy for customers to be encouraged to commit moral hazard, and the monitoring system is not optimal (Rahman as cited in Pangestu, 2018).

The moral hazard problems faced in mudarabah financing are the lack of Sharia ethics and deviations committed by financing customers. This deviation can be in the form of a lack of responsibility from untrustworthy customers in managing funds provided by the bank; for example, customers using funds that are not in accordance with those contained in the contract (Multifah et al., 2015). This will lead to an action that is not in accordance with the operational standards of financing, the principle of prudence, and the intentional act of fraud to enrich oneself. The next problem with moral hazard can be in the form of reporting the amount of profit that is not correct. Where mudarabah financing customers manipulate data about the amount of profit they generate, the data will be declared lower than it is. This type of customer manipulation is intended to reduce the customer's profit-sharing level with the bank below what should be distributed. So that mudarabah financing customers will get a larger share of profits than they should get.

Every cooperative collaboration, according to Islam, must be founded based on trust. This is because cooperation is a sort of economic mutual contact between two

people who form a cooperative contract via the bond of God. This suggests, in a roundabout sense, that when the two parties collaborate, the capital owner and the manager or agent share the tasks and duties that God has assigned to them. Islam believes that the agency problem will arise if the two parties carrying out the cooperation agreement are not trustworthy in carrying out their tasks (Sa'diyah & Huda, 2018).

The agency problem is a challenge for financial institutions operating in the micro sector. The inability of lenders to monitor borrower characteristics (for example, project risk), borrower efforts, or profitability is an information problem that can lead to inefficiencies in the microcredit market, even if microfinance might be regarded as an attempt to address these issues. The "principal" (the lender) attempted to do business with the "agent" in this case, resulting in an agency issue (the borrower). Information issues manifest themselves in three stages. First, some issues emerge before the lender (principal) makes loans to the borrower (agent). Lenders may have limited access to trustworthy information on loan quality. In certain situations, a short search by the loan officer might yield the needed information. However, due to the situations that frequently occur in the field, collecting information about borrowers is costly. However, the availability of accurate information can help to prevent lending to "low-quality" applicants. Second, after a loan is approved, the lender has no idea how the borrower will utilise the funds. Will the borrower put forth the effort to ensure the investment's success? Or, instead, might the borrower work fewer hours than he would if the project were completely self-financed? Third, after the Rate of return is realised, the lender may be unable to verify the amount of the return. This causes borrowers to be dishonest by claiming terrible luck (and requesting a loan repayment delay) when, in fact, it is a very profitable investment, especially with minimal liabilities to fulfil. With knowledge of the borrower's real earnings, the lender will be able to demand full payment and apply penalties that might potentially deter future misconduct by the borrower. Furthermore, borrowers' inability to get collateral is an issue in the microcredit sector.

Agency issues that develop before the execution of contractual arrangements are referred to as "adverse selection" issues. According to Armendáriz and Morduch (2010), Stiglitz and Weiss pioneered an adverse selection model in which banks lack solid knowledge of the borrower's project risk. As a result, banks are unable to

distinguish against dangerous borrowers, and interest rates are extremely high. These rates, in turn, drive qualified borrowers out of the credit market, resulting in market defects since eligible borrowers do not engage in credit markets when efficiency says they should. The degree of imperfection is exacerbated by the restricted amount of duty that must be completed. Problems with information hinder financial organizations from servicing more secure individuals, resulting in inefficiency and unfairness.

A more thorough example is provided below. We suppose that there are two categories of borrowers: safe and dangerous, and lenders have no way of knowing which is which. Lenders, on the other hand, only know a subset of the population's safe kinds. Again, all borrowers are risk-averse, and no one has collateral to back up their loans. And, once again, the lender is operating in a competitive environment, so he is just attempting to break even. So far, the examples indicate that the fact that lenders are ill-informed does not inevitably result in inefficiency. Asymmetric information has distributional effects (the safer borrowers suffer as a result), but there is no credit allotment and hence no assumption that the intervention would automatically increase the size of the cake. A simple example demonstrates that when banks lack knowledge, markets may become inefficient. Microfinance promotes itself as a means of overcoming inefficiencies, expanding market access, and improving distribution. Asymmetric information and moral hazard are two examples of challenges that formal sector commercial lenders encounter while serving low-income areas.

The study of moral hazard and adverse selection has two benefits: it gives a method for studying market flaws. Both are based on asymmetric information issues. Borrowers know more about their creditworthiness and risk tolerance than banks do. In the case of moral hazard, inefficiency occurs when the bank is unable to dissuade borrowers from taking excessive risks, increasing the chance of default. The issue is that debtors escape confronting the full repercussions of their conduct via default. Inefficiency due to adverse selection occurs when banks are unable to differentiate between safer and riskier borrowers. When this occurs, all borrowers are charged the same interest rate, and the safer borrowers effectively cross-subsidise the riskier borrowers. If the situation becomes severe enough, more secure borrowers will refuse to borrow at the current interest rate. The bank will subsequently be burdened with a riskier-than-average customer base.

Both adverse selection and moral hazard highlight major challenges that banks confront in low-income neighbourhoods, which are mostly driven by a lack of collateral. In this instance, raising interest rates in response to perceived risk might worsen the incentive problem to the point that earnings decrease rather than grow. Commercial banks are understandably hesitant to enter a market where collateral is limited, and transaction costs are high. If borrowers can be trusted to provide collateral to back their loans, both adverse selection and moral hazard can be eliminated. However, the borrower's starting point is that he lacks enough collateral. Therefore, it appears that for banks to perform better, a method to get more information is required; nevertheless, an essential assumption is that commercial lenders suffer significant expenses in obtaining additional information.

The microfinance innovation mentioned above offers novel solutions to this problem. One key element of this microfinance technique is that changes may be made even if the lender does not get more information. Contracts, on the other hand, utilise local knowledge and offer borrowers incentives to use their information about their peers to the bank's advantage. It is not that their understanding of the old information problem is incorrect; rather, they neglect to explore fresh ideas for avoiding the information problem. This debate also helps to explain why microfinance has mainly been carried out by new institutions rather than by attempting to engage, co-opt, or otherwise influence existing local lenders. Logic, for the most part, adheres to current business theory, which tries to explain why organizations exist rather than relying on contractors ranging from accountants to secretaries to carry out all transactions (Hart as cited in Armendáriz & Morduch, 2010). Although, as Fuentes (1996), indicated, incentive contracts may be created in theory to assist the recruitment of local lenders as bank agents, the actual execution is difficult. As a result, rather than attempting to develop the informal sector directly, most microlenders prefer to discover inexpensive and easy ways to enhance the informal sector.

Finally, the topic of moral hazard and adverse selection adds an essential viewpoint to the debate over interest rate setting. Adams, Graham, and von Pischke, as cited in Armendáriz and Morduch (2010), suggested that excessively low interest rates might undermine microfinance for political reasons. In a similar discussion, officials frequently argue that interest rates should be raised as high as required to completely

pay expenditures, or else the program will be fiscally unsustainable (e.g., Consultative Group to Assist the Poorest 1996). This has been a difficult discussion, and we all believe that carefully boosting interest rates can be the key to microfinance success. However, the study tells us that excessively high interest rates can also cause difficulties. Previous studies of moral hazard and adverse selection demonstrate how raising interest rates too high can harm the quality of an institution's loan portfolio and diminish profitability. When it comes to boosting interest rates, good intentions might go astray just as they did when charging excessively low interest rates. To guarantee adequate incentives for clients, microfinance must combine sensible interest rate regulations with novel business models. To guarantee long-term viability, microfinance companies have created novel microfinance frameworks. Group financing holds the entire group of creditors, rather than just the borrowers, liable for repayment. Joint responsibility serves as an ideal collateral substitute, promoting tracking, screening, and debt compliance. While costly, successful loan monitoring will assist MFIs in resolving difficulties caused by flaws. Loan control is critical for ensuring effective loan utilization and prompt payback. Understanding the risks connected with micro-loans necessitates an examination of market imperfections.

Using a simple economic model, Ghatak and Guinnane (1999) showed that the inclusion of community responsibility enhances the implementation of payback difficulties. Many MFIs have recently shifted to individual responsibility contracts rather than collective liability. Lenders are particularly concerned about the launch of a new "flexi-loans" platform, which they believe will be more risky and costly. Higher interest rates drive qualified borrowers out of the credit system, resulting in inefficiency. This is a market "imperfection" that raises interest rates and transaction expenses. Grameen Bank is changing its strategy to be more "flexible," allowing individuals to take advantage of another loan in the case of failure, helping them to get back on track. Loan monitoring is critical to ensuring effective loan utilization and early payback. The prevalence of informal side-contracting and significant default costs is critical to the efficiency of microcredit communication.

Analysing adverse selection and moral hazards is critical for identifying market flaws. While costly, successful loan monitoring can assist MFIs in resolving issues caused by these flaws (Abbink, Irlenbusch, & Renner, 2006). As a result, their findings

differ. When informal side-contracting is acceptable, the type of micro-loan contract is unimportant. However, in the actual world, side-contracting is still imperfect owing to "internal contract frictions." The public repayment meeting subsidises traditional collateral, and creditors can pool their resources to protect against default. Moral risks might manifest themselves in two ways. Customers may choose to falsify a huge loss or default and leave with the money. This is an example of an ex-post moral hazard. The second scenario arises when lenders are unable to verify that borrowers try to complete their micro-projects successfully. Lenders require an "internal" source of information to obtain feedback on each borrower's investment in the project. Ex ante moral risks can be reduced by screening and supervising peers in community loan schemes. Cason, Gangadharan and Maitra, as cited in Zouari et al. (2013), discovered that because peer monitoring is less expensive than lender monitoring, sequential group lending outperforms solo lending. Individually reliant contracts outperform in terms of capital gain, but rising interest rates over a particular threshold might have an impact on the quality of borrowers' portfolios. Group lending arrangements, which have reduced monitoring and compliance expenses, may be viewed as the most acceptable plan available to lenders.

Compared to conventional MFIs, the asymmetric information risk of IMFIs is lower. This is because the MFI uses a women-only approach, while the IMFIs favour a family approach. In addition, IMFIs also use murabahah and musharakah, which have been important techniques to prevent asymmetry. However, some investors consider the funding to be charitable finance that does not have to be paid out because they know that the financing comes from Sadaqat, zakat or waqf. Focusing on empowering the family approach in IMFIs, not empowering women, would be an effective way to minimise the asymmetrical information problems that exist in conventional MFIs (Ahmed, 2002). Another practice of IMFIs that prevents it from taking this risk is not offering cash. Instead of cash, goods/cash are handed over to the beneficiary under a murabahah contract. In Indonesia, the lack of public knowledge of Islamic finance is also due to a lack of detail. The belief that the funding in Islamic microfinance such as BMT is expensive with a convoluted mechanism is simply attributable to people's inability to find the right information. Another cause is the actions of some of the customers who have problems with BMT, and then the person spreads a word that is not true for BMT. Some consumers find it difficult to fulfil their obligations to BMT,

for example in terms of late payment of instalments, but then produce stories that have been attributed to BMT.

### ***3.4.3.2 Solutions to solve the Problem of Agency Conflict***

Group lending with shared responsibility might lower credit allotment because of adverse selection during the group formation stage. However, once a loan is approved, the bank may face moral hazard issues because of the difficulties in monitoring the borrower's behaviour. This part demonstrated how group lending with shared responsibility might avoid the problem of moral hazard in lending, decreasing credit limitations even more. Here, it considered the potential that group members who often live and work together may impose social or economic punishments on one another, a possibility that would be unlikely to be enforced by an external bank.

Stiglitz (1990) defined an ex-ante moral hazard method for group loans in his seminal early work on group borrowing theory. Their main argument is that group lending contracts create moral hazard ex-ante by encouraging borrowers to monitor each other's project choices and penalise borrowers who have chosen projects that are too risky. As Laffont and Rey pointed out in Armendáriz and Morduch (2010), the fact that group members are influenced by the actions and inactions of other members means that they will take steps to punish anyone who puts in the least effort and thereby burden the group with excessive burdens stake. Members of the group behave to maximise group revenue, and anybody who deviates is subject to severe social repercussions. Shared liability contracts rely on the group's power to punish individuals who try to avoid responsibility. Sanctions are less expensive in the Stiglitz and Varian models, although further work by others reduces monitoring and enforcement costs as part of the decision framework (Armendáriz,1999). Given the contract, the two sets of members would never shirk in principle, therefore the punishments were never applied. In theory, all that is required is the threat of its usage.

Assume that everyone is working hard, thus the worry of an ex-ante moral hazard is gone. Consider the issues that may arise once manufacturing is completed, and revenues are recognised. Borrowers may now be enticed to pocket revenue without

repaying the lender, which is a new source of risk (i.e., to "take" the money and run"). The difficulty is that the bank cannot tell the difference between a borrower who truly cannot pay back and a borrower who is attempting to flee with their profits. To add to the stress, it can be imagined that the borrower will undoubtedly fail on his debt in the absence of peer monitoring (whether he or she has the resources to repay). Everything else being equal, this type of ex-post moral hazard reduces the loan's scope since no bank will provide credit if it expects the borrower to avoid payment. Peer monitoring group loans, on the other hand, may motivate individual group members to spend ex-post monitoring expenditures to examine their peers' actual income realization. It is believed believe that with this knowledge, partners will be able to compel partners to pay.

By promoting peer monitoring and addressing enforcement difficulties related to ex post moral hazard, shared responsibility makes lending more sustainable. As a result, group loan arrangements outperform typical individual loan contracts. Under these conditions, the question arises whether microlenders can do better or not. If people continue to fail on their payments in group loans, and the amount due rises or the loan period ends, the leader and members of the borrowing group are put under pressure by field personnel. Field workers typically threaten to revoke loan access for members of the broad borrower group. Loan officers also hold meetings to monitor the loan status of the group of borrowers to determine whether borrowers in the broader village-level group have finished their loan as well as the current loan and will request the next (typically bigger) loan. These individuals are more sensitive to peer pressure to assist problematic customers. As a result, the loan officer may be inclined to inform this soon-to-be-reborrowing consumer that if aid in resolving the situation does not arrive, the expected loan may be postponed. To illustrate this point, loan officials were not unusual in refusing to leave the hamlet until the books were properly squared.

### **3.4 IDENTIFICATION OF RESEARCH GAPS**

Based on the literature review, several research gaps were found. In the practical aspect, further study is required to investigate the appearance of the agency problem, how it affects the financial performance of microenterprises BMT members, and the ensuing

consequences for continued access to finance for microenterprises. Additionally, it is necessary to identify the hurdles that hinder the implementation of BMT programs for microenterprise members and its solutions for microenterprise financial repayment performance especially related to principal-agent issues. From the knowledge aspect, this research tries to fill the gap by investigating and comprehending the empirical evidence of agency problem and the appropriate solutions in the context of microenterprise financing within Islamic cooperative microfinance organizations. The evidence of agency problem faced by Islamic microfinance organizations, specifically cooperatives, is guided by the Islamic contract theory, agency theory, and an overview framework from an Islamic perspective. On the methodological aspect, the qualitative approach was used in our research to get a thorough understanding of the topics presented in the case study. The participants of this study were derived from eight specifically chosen BMTs located in three regions of Indonesia, as well as institutions associated with BMTs and experts from academia and government agencies who are expected to provide more detailed and comprehensive insights into the research issues. This study addresses the lack of empirical research on agency concerns in microenterprise financing in Indonesia. It aims to find an intersection between the viewpoints of three key stakeholders: practitioners, academics, and policymakers.

Previous research has contributed to further research both conceptually and practically. This research includes discussing agency issues in IFIs in the form of a conceptual paper which explores agency theory from a conventional perspective to understand the various types of agency issues that arise in Islamic contractual relationships (Shamsuddin & Ismail, 2013) and explores the contrasting dynamics between various stakeholders within conventional and IFIs, using the agency theory perspective (Aljifri & Khandelwal, 2013). Several empirical studies in the Indonesian context were found, however, the existing research did not explain in depth the agency problem and how to solve it. Apart from that, the research object only includes one contract at one institution such as a bank (Adnan & Muhamad, 2007; Basuki, 2013; Jasmin et al., 2018), cooperatives (Jasmin, Moeljadi, Amaliya, & Malan, 2021), and BMT (Aminudin, 2020; Efrianto, 2019), or several BMTs but still in one district (Sa'diyah & Huda, 2018). On the other hand, research with a qualitative approach using triangulation techniques and data sources is still needed to provide an in-depth

understanding of agency problem and its solution, especially in cooperative Islamic microfinance institutions.

### **3.5 CONCLUSION**

This chapter reviewed various interconnected theories and frameworks from an Islamic overview continued by its empirical evidence. At the end of the chapter, the identification of research gaps was mentioned which shows the position and significance of the importance of the research carried out.



## **CHAPTER FOUR**

### **RESEARCH METHODOLOGY**

#### **4.1 INTRODUCTION**

Research method can be defined as a methodology for collecting data and analysing data, while approach refers to the techniques or instruments used by researchers to obtain empirical evidence. In more detail, research techniques are described as a systematic and orderly approach to data collection and analysis to generate information from the data. Methods, like techniques, cannot be right or wrong but can be useful based on their suitability with the hypotheses and procedures used, as well as the theory being tested and/or the research subjects selected. This chapter describes the methods and designs used in this study, namely the agency problem in microenterprise financing at BMTs in Indonesia. This chapter also describes the details of the sampling method and mechanism of data analysis selected in this study.

#### **4.2 RESEARCH DESIGN**

Research design is a type of research that has a clear direction for research design techniques with qualitative, quantitative, and mixed methods approaches. Others refer to the term research design as an investigative method (Denzin & Lincoln as cited in Creswell, 2014). Qualitative approaches to academic research suggest a different approach to academic studies than quantitative research methods. Even though the procedures are comparable, qualitative techniques rely on text and image data, require certain stages of data processing, and employ a variety of designs (Creswell & Poth, 2018). Within qualitative research, the number and style of methodologies have also become increasingly apparent in the 1990s and the twenty-first century. Historical sources of qualitative analysis include anthropology, sociology, humanities, and judgment.

The study of research topics that address the nature of social or human problems to people or groups is guided by the assumptions and application of interpretive/

theoretical structures in qualitative analysis. To investigate these issues, qualitative researchers use advanced qualitative research techniques, data collection in natural settings that are sensitive to the people and places studied, and inductive and deductive data processing and identifying trends or themes. The final written report or presentation includes participant voice, researcher reflexivity, detailed explanation and analysis of the problem, and addition of literature or requests for change (Creswell, 2009).

In this research, qualitative research is used to develop an in-depth picture of a scenario, which often takes the form of a program, event, method, or one or more people supplemented by other data collection techniques, namely observation, documentation, and qualitative surveys as well as using source triangulation as well. Cases are limited by time and operations, and researchers obtain a great deal of information over a long period using various data collection approaches (Stake; Yin as cited in Creswell, 2014).

Research on agency problem in BMT micro-business financing needs to be done through qualitative research, as it offers a comprehensive understanding of the subtle dynamics and personal experiences involved in financial exchanges that quantitative techniques alone may not represent. This inquiry is necessary, in turn, because there is a need to research complex and in-depth knowledge of issues for groups or communities, to find variables that cannot be measured easily, or to hear suppressed voices. These are all compelling reasons to investigate a topic rather than relying on preconceived book knowledge or conclusions from previous study investigations. This level of information can only be obtained by speaking with individuals privately, visiting their homes or workplaces, and encouraging them to share their experiences without regard to what we anticipate finding or what researchers have read in the literature. For this type of qualitative approach, case study analysis will be used in this study, which will analyse real-life, contemporary finite systems (cases) or multiple finite structures (cases) over time, through comprehensive and in-depth data collection. involve multiple sources of information (e.g., observations, interviews, audiovisual content, notes, and through reports. The research unit in a case study can be several cases (multi-case study) or one case (cross-case study). A case study is an approach that is successful when the investigator has identifiable case boundaries and aims to provide an in-depth understanding of a case or a comparison of several cases (Creswell & Poth, 2018). A case study aims to provide an in-depth examination of a particular case, which

is usually a program, events, activities, processes, or one or more people. Cases are determined by time and activity, and researchers collect extensive data over time using various data collection approaches (Stake; Yin as cited in Creswell, 2009).

Several stages in conducting a case study are: a) deciding whether a case study approach is suitable for studying a research problem, b) classifying study objectives and selecting cases, c) establishing procedures for carrying out comprehensive data collection using various data sources, d) determining the methodology research in which case summaries incorporate analytical themes and contextual knowledge, and e) report case studies and lessons learned using case statements in written form (Merriam & Tisdell; Stake; Yin, quoted in Creswell & Poth, 2018).

### **4.3 CONCEPTUAL FRAMEWORK**

A conceptual framework (model) is a collection of theoretical concepts used to analyse a core phenomenon, with a less rigid structure compared to theories (Fain, 2009). It serves as a framework for conveying a specific worldview and facilitates the generation of empirically examined hypotheses. The term "framework" refers to the fundamental intellectual basis of a study, often used interchangeably in literary works. When conducting a study based on a specific conceptual model, the framework is commonly referred to as the theoretical framework. This research is based on a certain conceptual model which will be explained briefly.

Agency theory proposed by Jensen and Meckling (1976) argues that agency relationships include transferring some decision-making responsibility to agents. If both parties are utility maximisers, there is reason to think that the agent will not always operate in the principal's best interests. Growth in microenterprises or small enterprises can be an important means of employment generation and the development of poor countries. In addition, microenterprises can play a significant role in employing the surplus labour force productively. Microenterprises in developing economies are more vulnerable to adverse selection (Stiglitz & Weiss, 1981) and moral hazard (Akerlof, 1970) than larger companies due to additional restrictions and challenges. These include low wages, high financing costs, and the usage of basic technologies (Beck, Demirguc-

Kunt, & Levine, 2005). Small business growth can be hampered by a lack of input and output markets, as well as inadequate infrastructure. Poverty might increase the moral hazard problem for microentrepreneurs owing to a lack of collateral. Inadequate infrastructure, such as a lack of markets, roads, power, and communications, can worsen both the adverse selection and moral hazard issues. The cost of loan processing rises as the amount of the loan for microenterprises becomes lower.

In the context of financing in Islamic microfinance institutions, it can be drawn on the existence of agency problem in financing microenterprises in BMT. However, the theory of Islamic firms Sarker (1999) and Azid, Asutay, and Burki (2007) state that producers will behave as efficient entrepreneurs as well as Islamic men to honour the goals of Islamic Sharia for achieving social welfare and will put their whole endeavour to maximise production at a level where total revenue is equal to total cost. According to Islamic banking and finance theory (Siddiqi as cited in Rahman, 2007), Islamic finance is founded mainly on the prohibition of Riba. Thus, the main aim of Islamic banking and finance is to provide an Islamic alternative to the conventional system that is based on Riba. Profit and loss sharing arrangements are regarded as an ideal mode of financing in Islamic finance as an alternative to Riba. Some contracts have a lot of potential for advancement and adaptation as Islamic microfinance schemes, namely: Mudarabah, Musharakah, Murabahah, Ijarah, and Qardhul Hasan. Furthermore, the unique aspect of BMT, which has several programs as described by Wulandari and Kassim (2016), namely the screening process and social development program, is believed to be a solution for agency problem, which for micro-business financing customers can be implicated through behavioural changes based on Islamic moral teaching, repayment performance improvement, and for the economy to increase its role in the country's economic development.

The nature of the contract in conventional theory shows that there is no aspect of human behaviour with God or faith (Shamsuddin & Ismail, 2013). For example, the object of the contract being transacted has nothing to do with religious beliefs and practices. Meanwhile, the Islamic contract begins with normative human behaviour and then its relationship with God and faith. In other words, in relation to contracts in Islam, Allah SWT is the witness of all contracts. The subject matter and transactions in the contract must be religiously halal, which means they must be in accordance with Divine

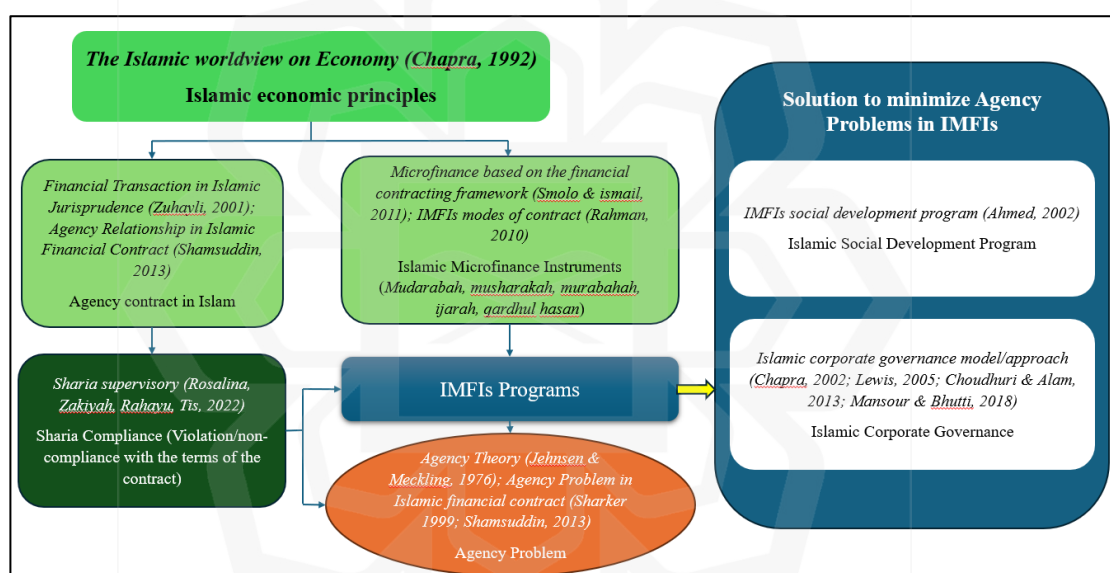
law stated in the Qur'an and Hadith. This is closely related to the idea of tawhid, or the oneness of God, which is important in the Islamic religion, stating that perfect truth is the foundation of the universe and its ultimate fate is completely in God's hands (Rahman, 1998). This concept is taken from creation, truth, knowledge, life, humanity, revelation, and reason. It is also connected to the caliphate, which implies that humans act as God's agents and deputies when interacting with the cosmos and their environment. The principle of tawhid, which emphasizes collaboration and involvement in an organization, is unique to Islamic teachings and is unique to the caliphate concept. In Islamic agency relationships, actors must comply with Islamic principles, norms, laws, and regulations. The Qur'an and hadith emphasize the need to feel the presence of Allah in all activities, reducing information asymmetry and ensuring a well-established agency contract.

Islamic finance improves agency relationships by including moral and ethical elements, using PLS-based contracts, reducing information asymmetry, and having a Sharia-based supervisory board. This ensures stakeholder interests are protected, commercial and social aspects are balanced, and transactions are approved based on Sharia principles. Representatives, especially those practicing Islamic ethics, are obliged to fulfill their obligations honestly, reducing agency problem such as lies, negligence, and opportunistic efforts. Taklif, or personal responsibility, is important for agents who believe in ultimate accountability by God.

Conflicts between agents and principals can arise through the principle of shura, which emphasizes open-mindedness, respect, trust, and acceptance of differences. The Qur'an emphasizes submitting differences of opinion to Allah and His Messenger for the best and fairest resolution possible. Islamic agency contracts require both parties to provide the highest level of participation and cooperation, limited by Sharia rules, to achieve the organization's primary objectives.

IMFIs, such as BMT, have been shown to effectively alleviate poverty in Indonesia by providing financial services and access to the poor. They have dual roles, serving as both commercial and social entities. BMT's unique characteristics, such as a social development program as part of credit-plus financing, are believed to mitigate risks due to asymmetric information. However, BMT faces challenges in its operations,

such as screening processes, credit-plus financing implementation, and the issue of default on poor borrowers due to poor governance and the limited capacity of HR. On the other hand, Ardiansyah (2014) stated that although theoretically there is a clear difference between conventional and Sharia transaction paradigms, many Sharia transactions are still strongly based on a conventional mindset. Based on the Islamic perspective, Firdaus and Ahmad (2023) assert that cooperation in collaboration with the concept of working together and mutual assistance is the main economic strength which can also be adopted in BMT strategy to support its program's implementation. The conceptual framework in this research is illustrated in Figure 4.1.



Source: various sources (compiled by the author)

Figure 4.1 Conceptual Framework of The Study

Figure 4.1. describes that every activity of every Muslim is underpinned by the six principles of Islamic economics: unity, vicegerent (caliph), justice, brotherhood, efficient utilization of resources, and ethics and norms. The economic system in Islam has its roots in Sharia which will derive from its worldview, goals, and strategy. The goals of Islam are based on its concepts of human well-being (falah) and good life (hayat thayyibah) which give utmost importance to brotherhood and socio-economic justice and require a balanced satisfaction of both material and the spiritual needs of all human

beings (Chapra, 1992). Contract formation is crucial for legal significance and ensuring guidelines for parties involved in transactions, whether in conventional or Islamic financial contracts. Formal contracts represent premises, responsibilities, and obligations. However, asymmetric information can create incomplete contracts, leading to hazard problems. In contrast, Islamic contract theory provides fundamental procedures for contractual transactions between parties (Shamsuddin & Ismail, 2013; Zuḥaylī, 2007).

IMFIs differ from conventional ones in specific transactions and adherence to Sharia compliance principles. These institutions avoid prohibited practices like *riba*, *gharar*, *maysir*, and *tadlis*. They face risks of material losses and violations of Sharia law. IFIs must adhere to Sharia compliance, ensuring thorough application of these principles in their operations. This supervision ensures intermediation functions remain based on Sharia principles (Rosalina, Zakiyah, Rahayu, & Tis, 2022). Some contracts have great potential to be advanced and adapted as Islamic microfinance schemes, namely: *Mudarabah*, *musharakah*, *murabahah*, *ijarah*, and *qardhul hasan* (Rahman, 2010; Smolo & Ismail, 2011). On the other hand, conventional MFIs' social development programs are secular, while IMFIs introduce Islamic principles in behavioural, ethical, and social aspects. This approach benefits people by making them more comfortable with Islamic norms and building social capital for regular instalment repayment (Ahmed, 2002). Corporate governance in Islam is based on the Islamic worldview of *Tawhid*, which emphasises unity of divine law and knowledge (Choudhury & Alam, 2013; Dusuki, 2008). It involves the organization and sustainability of processes, involving corporate social responsibility and decision-making through discourse induced by moral consciousness. The goal of corporate governance is to evaluate and simulate the degree of unity of knowledge gained through the application of *maqasid as-shari'ah* (Choudhury & Alam, 2013; Ahmed & Chapra, 2002; Lewis, 2005; Mansour & Bhatti, 2018).

The agency problem is a significant issue in organizations, affecting all levels of management. The agency theory aims to explain agency costs and their formation, leading to a rich theory of organizations. It analyses agency costs generated by contractual arrangements between owners and top management, focusing on positive aspects, assuming individuals solve normative problems, and investigating incentives

faced by each party. It also examines the equilibrium contractual form between managers and outside equity and debt holders (Jensen & Meckling, 1976). Agency is the management mechanism for production firms or business enterprises, governed by contracts and agency costs. The growth of enterprises is determined by remuneration and productivity. Islamic banking offers optimal risk allocation through project returns sharing between capital owner and entrepreneur. However, it faces principal-agent problems due to asymmetric information and costly monitoring. Asymmetric information can lead to adverse selection problems, costly monitoring expenses, and moral hazard problems. This susceptibility may make an Islamic bank uncompetitive with conventional rivals due to additional deadweight costs in information-gathering and project appraisal (Sarker, 1999).

Financing transactions can involve contracts that adhere to Islamic beliefs. Certain contracts include an agency relationship. If a Muslim adheres to the fundamental tenets of Islamic economics, such as the customer or IMFI in this scenario, the contract can be lawfully and fully completed. Failure to adopt the fundamental principles of Islamic economics will result in the emergence of agency difficulties. Within the context of Islamic economic assumptions, agency difficulties may arise because of both internal and external influences within an institution. By adhering to the fundamental principles of Islamic economics, this agency problem can be addressed, and its associated risks can be reduced.

#### **4.4 ASSUMPTIONS OF THE STUDY**

Following the conceptual framework of the study, the assumptions in this study are as follows:

1. Agency problem still exists in microenterprise financing of BMT in Indonesia. These problems include adverse selection leading to credit rationing as it encourages lenders to charge high margin rates on everyone to offset the possibility of having high risk borrowers within the customer population, an ex-ante moral hazard which affects the likelihood of achieving good returns, and post-ante moral hazard when the lender does not fully

monitor the borrower's returns or when the lender observes returns but is unable to compel repayment by the borrower.

2. Several factors are the cause of agency problem in micro-business financing at BMT, namely: a poor financing management system, low Islamic financial literacy on both the BMT staff and BMT members, and Sharia compliance issues on financing contract implementation.
3. Different features and special characteristics of BMT together with instilling values and principles based on the Qur'an and Hadith in BMT financing activities which are implemented in its programs can minimise the occurrence of agency problem in microenterprise financing of BMT in Indonesia.
4. BMT faces many challenges in implementing its programs which need a solution that program implementation.

#### **4.5 POPULATION AND SAMPLE**

In this study, data were collected through interviews, observation, analysis of existing documents, and qualitative surveys. The researcher can also act as a full observer without getting involved in a study subject that may be difficult for participants to explore. Interviews with the head and/or manager of the BMT, as well as several BMT staff, and BMT experts from regulators, related associations or institutions, and academics will be conducted to explore the main data in this study. Observations, qualitative surveys, and document reviews will be used to provide additional information for a more in-depth analysis of the issues raised in the research topic. The population of the study include 3955 BMTs in Indonesia and BMT experts from regulators, related associations or institutions, and academics. The research employs non-random sampling methods, also known as non-probability sampling methods, which are commonly utilised in qualitative research (Gill, 2020). Every non-probability sampling method possesses both advantages and disadvantages. This study employed purposive sampling, a method that can be demanding in terms of identifying participants with valuable information. However, it offers the advantage of selecting participants who are most advantageous to the study, while also being cost-effective and utilising diverse strategies (Gill, 2020).

Given the difficulty of finding data on the topic, limited funds allocated and limited time, this research focuses on BMTs in Indonesia with three main sampling areas – western Indonesia, central Indonesia and eastern Indonesia and supplemented by representatives of the Indonesian BMT association. The western region is represented by Banten, East Java, Central Java, and Yogyakarta. The central region is represented by West Nusa Tenggara and South Sulawesi, and the eastern region is represented by Southwest Papua. These cities were chosen because they have the highest number of BMTs and higher population density in each area which is considered the largest concentration of poor people, according to data from the Ministry of Cooperatives & SMEs and the Central Bureau of Statistics. In addition, the selected BMTs are certified Sharia cooperatives and are included in the oldest BMTs established in each province which are considered to have had longer and sufficient experience for data mining. For a meaningful qualitative study; The sample size is 6 to 10 people with sufficient expertise and information (Malterud, Siersma, & Guassora, 2016). Other experts believe that fifteen people were considered the smallest sample size acceptable in qualitative research (Guest, Bunce, & Johnson, 2006). In this study, the sample size used was 49 participants, which was more than sufficient for the existing sample size requirements.

Data were collected through interviews and qualitative surveys with the chairmen and/or managers and staff from eight BMTs in Indonesia with several criteria that have been mentioned and added to by participants from BMT associations, and experts from both regulators and academics. Observation and document analysis activities were also carried out to provide additional information and strengthen research data. In accordance with ethical standards and considerations (Sharofiddin, Idris, & Othman, 2018), the identities of these experts and the names of the institutions remain confidential. They are not disclosed to ensure the utmost secrecy. Their profiles were succinctly summarised, and a specific coding (IMFIs1- IMFIs8, Inst.1- Inst.4, R1-R4, and Ac1-Ac4) was assigned to each for reference in this research. The following is a list of research participants:

Table 4.1 Research Samples Data (RSD)

<b>RSD from BMT</b>		
<b>BMT ID</b>	<b>Respondent of The Research</b>	<b>Number of Samples</b>
IMFIs1	Chairman/Manager and staff	4
IMFIs2	Chairman/Manager and staff	4
IMFIs3	Chairman/Manager and staff	4
IMFIs4	Chairman/Manager and staff	3
IMFIs5	Chairman/Manager and staff	4
IMFIs6	Chairman/Manager and staff	6
IMFIs7	Chairman/Manager and staff	3
IMFIs8	Chairman/Manager and staff	4
Total number of participants		37
<b>RSD from BMT Members</b>		
IMFIs1	BMT Member	5
IMFIs2	BMT Member	5
IMFIs3	BMT Member	3
IMFIs4	BMT Member	11
IMFIs5	BMT Member	3
IMFIs6	BMT Member	4
IMFIs7	BMT Member	3
IMFIs8	BMT Member	2
Total number of participants		36
<b>RSD from BMT Association</b>		
<b>Organization/Association ID</b>	<b>Respondent of The Research</b>	
Inst.1	Active member and ex-chief	1
Inst.2	Financing manager	1
Inst.3	Head of Institution/Association	1
Inst.4	Head of microfinance division	1
Total number of participants		4
<b>RPD from Experts 1 (Regulator)</b>		
<b>Organization/Association ID</b>	<b>Respondent of The Research</b>	
R1-R2	Sharia Financial Services Cooperative Division	1
	Chief of Division	1
R3-R4	Sharia Microfinance Division	1
	Financial Inclusion Division	1
Total number of participants		4
<b>RSD from Experts 2 (Academics)</b>		
Academics	Ac1	1
	Ac2	1
	Ac3	1
	Ac4	1
Total number of participants		4
<b>TOTAL NUMBER</b>		<b>85</b>

Source: the author

It can be seen from Table 4.2 that this research design uses a qualitative approach through interviews and/or qualitative surveys with 49 samples who come from BMT practitioners, and experts from academia and regulators as well as supplemented by observations of the eight BMTs and analysis of related documents. The BMT locations that are the object of research cover seven provinces from three regions in Indonesia (Indonesia, 1987) which can be seen in Table 4.3 and Figure 4.2.

Table 4.2 Location of BMT Research Object

Region	Province	Regency
West Indonesia	Banten	Tangerang
	Central Java	Rembang
		Wonosobo
	Yogyakarta	Yogyakarta
East Java	Pasuruan	
Central Indonesia	West Nusa Tenggara	East Lombok
	South Sulawesi	Sinjai
East Indonesia	Southwest Papua	Sorong

Source: the author



Source: processed by the author

Figure 4.2 Distribution of Research Object Locations in Indonesia

## **4.6 PROCEDURES**

### **4.6.1 Expert Validation**

Conceptually and practically, expert instrument validation is a two-part procedure. The conceptual definition consists of a survey of the relevant literature which leads to the development of a theoretical framework. It is recommended that a panel of five subject experts with professional experience in the topic under discussion be formed. University professors and/or postgraduate students in fields according to the research topic raised can be suitable alternative experts. Experts must have sufficient information to properly assess the proposed instrument.

Several reasons are discussed why expert validation is important for the development of an instrument, in this case measuring agency problem in less financing in BMT. First, expert analysis is a way to show whether the question items posed adequately represent the intended content in a particular area, which is an agency problem in micro-business financing in BMT. The experts that will be selected to critique these items represent individuals who have a high level of knowledge in the target area and with that knowledge can judge whether the item in question effectively represents the research objective. They are considered as a guide for the initial basis for the development of instruments to be used in data mining in the research field. Second, expert validity is a stage in the instrument development process that determines whether the theoretical framework and knowledge base are properly represented in each item. Without expert analysis, items will not be properly represented from the content area in question.

In this study, seven experts will participate in the evaluation of survey instruments during July 2022. The criteria for selecting the seven experts are related to their knowledge of agency, financing, accounting and BMT issues in Indonesia. as pre- and post-assessment for prospective research participants. The criteria deemed valuable for the selection of experts are based on (a) individuals who have theoretical knowledge of financing in IFIs, (b) individuals who publish literature in the field of Islamic economics and/or finance, and/or (c) individuals who have academic experience, practitioners, and/or policymakers related to BMT in Indonesia. In accordance with research ethics, it is stipulated that experts cannot be selected if they are directly related

to research (i.e. members of the dissertation committee) and if they do not have knowledge in the field of study concerned. Using the selection criteria, the researcher listed ten possible experts to participate to select a total of seven. Any expert who can be referred by members of the dissertation committee, such as the co-chair of the dissertation, was considered as a possibility.

Each expert was contacted via WhatsApp and email with an invitation to participate in the expert assessment section of the research. Regular contact following an invitation to participate in research was done via email and telephone to notify prospective experts to respond as soon as possible. Deadlines were given to each member to assist with their quick response upon receipt of the reminder and invitation email. The estimated time limit for the first response is one week after acceptance to respond by accepting or declining expert participation for this study. After determining the criteria for selecting experts, survey questionnaires will be distributed to experts who are willing to participate in expert validation. Expert questionnaires are designed to provide critical analysis of each survey item in an easily accessible way. Each item on the survey instrument is categorised into four according to the research objectives. Three follow-up questions are asked for each item, namely: (a) Is the question item valid or invalid (b) Do you suggest a wording change to improve understanding? Please provide specific feedback, and (c) Is this question item appropriate and appropriate for exploring and investigating agency problem in micro-business financing at BMTs in Indonesia? Why or why not? All materials are provided to experts via online survey forms and emails. Approximately three weeks are targeted for the completion of the questionnaire by each expert after their acceptance.

#### **4.6.2 Pilot Study**

Pilot interviews, which were conducted in this study, lasted 80-90 minutes each. The informants consisted of two BMT practitioners, two academics and practitioners at BMT, and an academic, researcher and practitioner at IMFIS. The purpose of the researchers conducting the sample interviews was to test the research interview questions and protocol. The researcher wanted to understand how the informant reacted

to this and to ascertain the quality and range of insights that participants are expected to share in the future.

For a larger study, the researcher aimed to obtain a sample group consisting of four experts from policymakers, four experts from academia, 37 BMT practitioners in Indonesia and four practitioners from BMT associations. After collecting the initial interviews, it was assessed whether sufficient diversity was achieved or whether new strategies were needed to increase the outreach of shared perspectives.

The research question for the overall study is how agency problem occur and what are the solutions to overcoming agency problem in the context of micro-business financing at BMTs in Indonesia. In assessing this, we will consider sub-questions including: what is the agency problem that occurs in micro-business financing in BMT? How did this agency problem come about? How is the BMT program an effort to minimise agency problem? What are the strategies offered to minimise agency problem in micro-business financing at BMT? Any suggestions/inputs related to this research?

Within the realm of qualitative research, face-to-face interviews have become the dominant interviewing approach. Telephone interviews have been prevalent for the previous two decades. Other interviewing approaches can be applied due to the rapid expansion of new communication channels such as e-mail and chat boxes (Opdenakker, 2006). In this pilot study, the researcher used two interview methods, namely face-to-face interviews and online interviews using a Zoom call meeting. One of the informants also gave written interview answers in Microsoft Word and then continued with online interviews using a zoom meeting to reconfirm the answers that had been submitted. The researcher started by asking the participants to "provide feedback related to micro-business financing to BMTs." The researcher continues by asking questions related to "contracts/contracts used in micro-business financing" then the researcher continues with more specific questions related to agency problem in micro-business financing in BMT. During each pilot interview, the researcher asked each participant their opinion using a semi-structured dialogic approach about:

- Agency problem in microenterprise financing in BMT

- Causes of agency problem in microenterprise financing in BMT
- BMT program in overcoming agency problem in microenterprise financing in BMT.
- The strategy offered to minimise agency problem in microenterprise financing of BMT.

#### **4.7 DATA ANALYSIS**

The data analysis technique in this study was to examine the data through case summaries and case themes as well as cross-case themes. Data analysis includes open data collection based on general questions and analysis of information provided by participants (Creswell, 2014). There are several stages in research documentation, namely: presenting a written report with an entry vignette then focusing on the core characteristics of the case, explaining research procedures by establishing reasoning, sorting, and data procedures, compiling research results by first presenting a detailed explanation of the case followed by key issues (themes or problems) in the case, and the vignette conclusion.

Data Collection activities in the sense of case study research can be characterised as a bounded structure, such as a process, operation, event, program, or many individuals. Access and reporting procedures carried out by gaining access through the gatekeeper earn the trust of the participants. The objective sampling technique is carried out by identifying “cases” or “cases”, “atypical” cases, or “full variation” or “serious” cases. Information is usually collected in a comprehensive form, such as documentation and notes, interviews, observations, and physical objects for one to four examples. This knowledge is usually stored in the form of field notes, transcripts, and digital files.

The process of collecting case study data requires a wide variety of techniques as the researcher generates an in-depth picture of the case. The various ways of data collection suggested by Yin as cited in Creswell and Creswell (2018) in their case study

book, refers to six forms: documents, archival records, interviews, direct observation, participant observation, and physical objects. An analytical technique was chosen for this study, which involved several steps, namely: taking notes while reading reflective thought sketches, summarising field notes, working with terms, defining the code, reducing the code to themes, calculating the frequency of the code, associating with categories related to the analytical framework in literature, establishing viewpoints, and displaying and reporting data. Analysis and representation of data in case studies are accomplished by creating and organising data files, reading text, making margin notes, establishing initial codes, defining cases and their meanings, using category aggregation to establish themes or patterns, and using direct interpretation to build naturalistic generalizations of what who have been “learned” in data representation and visualization. The data review process will be carried out as proposed by Creswell and Creswell (2018) namely that at various levels of analysis, data is organised and prepared to be analysed, read or viewed, start coding all data, generate descriptions and themes, and represent descriptions and themes.

One of the characteristics of qualitative research is its focus on determining whether the results are correct from the point of view of researchers, participants, or report readers (Creswell & Creswell, 2018). Multiple data sources will be triangulated to validate facts by examining evidence from sources and used to build a cohesive case for themes. If the theme is formed based on the convergence of different data sources or the views of the participants, this approach can be said to increase the validity of the research. In this study, as stated by Creswell (2014), the following steps will be carried out to analyse the data:

1. Prepare data for analysis by organising and preparing it. This includes transcribing interviews, scanning material optically, typing up field notes, classifying all visual material, and sorting and organising data into different types based on the source of the information.
2. Read or review all data and make sure that all data must be read or viewed. This initial stage provides an overview of the material as well as an opportunity to comment on its overall significance.

3. Start coding all the data. The coding process in this study used the NVivo Qualitative Data Analysis Software (QDAS). It is feasible to organise, retrieve, and analyse qualitative data using this QDAS without losing its richness or proximity to data that is essential to qualitative research (Bazely & Richards, 2013). Researchers use QDAS such as NVivo and ATLAS.ti as examples for data analysis and/or data management (Woods, Paulus, Atkins, & Macklin, 2016). Based on the data reported by Woods, Paulus, Atkins, and Macklin (2016), NVivo is the QDAS most widely used in research (published in peer-reviewed journals between 1994-2013, namely 414 publications). From these publications, for case studies, researchers use NVivo more than other QDAS, namely ATLAS.ti. For data types, compared to ATLAS.ti, NVivo is more widely used for interview data, documents, surveys or questionnaires, conversational data, online social media data, and websites. Compared to Atlas.ti, NVivo is also more widely used for research in the fields of business and social sciences.
4. Use the coding process to create descriptions of environments or individuals, as well as categories or topics to be studied. Comprehensive depiction of information about people, locations, or events in a context is known as description.
5. Interpret the findings or outcomes of qualitative research as the ultimate phase of research data analysis, use theme analysis, a suitable methodology when samples are predetermined and specified before commencing the study (Alhojailan & Ibrahim, 2012). The process of thematic analysis involves coding and classifying the data into thematic subjects. Evaluating this step is crucial as it ensures the comprehensive representation of the entire text (Alhojailan & Ibrahim, 2012).

### **Stages of Coding**

Coding is the analysis phase by reviewing a series of field notes, transcribed, or synthesised, and dissecting them in a meaningful way while keeping the relationships

between parts intact. Codes are tags or labels for assigning units of meaning to descriptive or inferential information compiled during research. The code is used to fetch and set the previously mentioned snippets. The organising part will require some system to categorise the various pieces so that the researcher can quickly find, draw from, and classify segments related to certain research questions, hypotheses, constructs, or themes for which conclusions can then be drawn (Miles & Huberman, 1994). According to Saldaña (2013), codes in qualitative inquiry are most often words or short phrases that symbolically provide summative, salient, essence-capturing, and/or evocative attributes for some language- or visual-based data.

According to Saldaña (2013), the coding method is divided into two main parts: the First Cycle and Second Cycle coding method, with a hybrid method located between the two. The First Cycle Method is the processes that occur during the initial data coding and are divided into seven subcategories: Grammar, Elements, Affective, Literature and Language, Exploration, Procedural, and the final profile entitled Data Theme. The Second Cycle method is a bit more challenging because it requires analytical skills such as classifying, prioritising, integrating, synthesising, abstracting, conceptualising, and building theory (Saldaña, 2013). This study will use the In-Vivo Coding method for the first cycle of coding and then proceed with the Pattern Coding method for the second cycle of coding.

## **Stage 1. First-cycle coding**

### **In Vivo Coding**

According to Saldaña (2013), In Vivo Coding, also known as "literal coding", "verb coding", "inductive coding", "native coding", and "emic coding", is a widely used qualitative method that involves extracting native terms from words. words generated by participants from a particular culture, subculture, or microculture. These indigenous terms indicate the existence of a group's cultural categories and can be extracted using the subculture's unique vocabulary or argot. In Vivo Coding is suitable for almost all qualitative research, especially for novice researchers learning how to code data and research where participants' voices are prioritised and respected. This is one of the methods used during grounded theory Precoding and can be used with some of the other

coding methods in this manual. In Vivo Coding also applies to action research and practitioners, as it frames the facilitator's interpretation of terms used in everyday life, not those from an academic discipline or professional practice. This method provides a heightened awareness of individual unique circumstances and lends itself well to qualitative research where participants' voices are prioritised and respected.

## **Stage 2. Second-cycle coding**

### **Pattern Coding**

Pattern coding is an explanatory or inferential code that identifies the theme, configuration, or explanation that appears (Saldaña, 2013). This method is a meta-code that groups the summary into smaller sets, themes, or constructs. They are suitable for a wide range of applications, such as second-cycle coding, developing major themes from data, searching for rules, causes, and explanations, examining social networks and patterns of human relations, and forming theoretical constructs. To analyse Pattern Codes further, researchers can use action and practitioner research, statement development, content analysis, decision modelling, grounded theory, interactive qualitative analysis, logic models, mixed methods research, qualitative evaluation research, and situational analysis. This method helps to understand and interpret data more meaningfully and effectively.

## **4.8 VALIDITY AND RELIABILITY**

The four trustworthiness principles in qualitative research proposed by Lincoln and Guba (in Nassaji, 2020) are credibility, transferability, dependability, and confirmability. These criteria align with the concepts of internal validity, external validity, reliability, and objectivity employed in quantitative research. Credibility pertains to the veracity of study findings and their alignment with the topic under investigation. Implementing strategies such as member checking or participation validation can assist in accomplishing this goal. Transferability pertains to the degree to which researchers' interpretations or results can be applied to comparable contexts. Dependability is a concept that can be used instead of reliability. It means that the study should be presented in a manner that allows others to reach comparable judgments.

Confirmability, in the context of quantitative research, shares similarities with objectivity as it highlights the researcher's active involvement and participation in the study process. Confirmability can be ensured by presenting facts and findings in a manner that allows others to independently verify their veracity. A highly efficient approach is the implementation of an 'audit trail', in which the researcher meticulously documents and justifies every data coding and analysis decision. The term qualitative validity refers to the use of certain processes by researchers to ensure the correctness of the results, while qualitative reliability refers to the research methodology that is consistent across various studies and projects (Gibbs as cited in Creswell, 2014). Triangulation of Data Sources will be used to test validity through the convergence of information from different sources. In addition, to strengthen research data, researchers also conducted observations, qualitative surveys, and analysis of related documents.

In qualitative research, triangulation refers to the use of multiple methods or data sources to develop a comprehensive understanding of a phenomenon (Patton, 1999). Triangulation is also seen as a qualitative research strategy to test validity through the convergence of information from various sources. Patton (1999) identified four types of triangulation: (a) method triangulation, (b) researcher triangulation, (c) theory triangulation, and (d) data source triangulation. Method triangulation involves the use of several methods of collecting data about the same phenomenon (Polit & Beck as cited in Carter et al., 2014). This type of triangulation, often used in qualitative studies, can include interviews, observations, and field notes. This study uses data source triangulation which involves collecting data from different types of people, including individuals, groups, families, and communities, to gain multiple perspectives and data validation. Fontana and Frey (as cited in Carter et al., 2014) describe the In-depth interview (IDI interview) as one of the most powerful tools for gaining an understanding of people and exploring topics in depth. IDI interviews, ranging from structured and controlled to unstructured and fluid, can glean a great deal of information about personal experiences and perspectives (Russell, Gregory, Ploeg, DiCenso, & Guyatt as cited in Carter et al., 2014). The IDI interview allows for spontaneity, flexibility, and responsiveness to the individual; however, conducting interviews, transcribing discourses, and analysing texts often requires a great deal of time and effort (Carter et al., 2014).

For qualitative reliability, this study uses various qualitative reliability techniques provided by Gibbs as cited in Creswell and Creswell (2018) which will be used to assess the reliability of the results. The qualitative reliability procedure is to review the transcripts to ensure that the transcripts do not contain obvious transcription errors, to ensure that there are no deviations in the description of the code, and to ensure that there are no changes in the interpretation of the code during the coding process, which can be achieved by constantly comparing data by code and by writing memos about the code and its definitions. In this study, the data was coded using the N-Vivo 12 plus software which a range of credibility, transferability, dependability, and confirmability techniques used to increase the trustworthiness of the study as proposed by Jakobsen and McLaughlin (2004).

It is necessary to verify the authenticity of the topics, by including three independent reviewers in two separate phases, to ascertain any conflicting results if any with respect to any topics added or removed, and to build reliability in coding topics analysis (Huberman & Saldana, 2014). To ensure confirmation, the researcher acquired feedback from two experts (Wesnawa et al., 2022) in the field of Islamic microfinance. The purpose was to verify and evaluate the data coding results on nodes and categories, ensuring their accuracy and relevance to the research issue.

#### **4.9 CONCLUSION**

In this research, qualitative research is used to develop an in-depth picture of a scenario, which is often a program, event, method, or one or more people. A type of case study was chosen to investigate the institution's problems in financing BMT microenterprises. Research data were collected through interviews, observation, and analysis of related documents. Data analysis will be carried out through several steps, namely: preparing and organising data for analysis, reading all data, coding, describing, and interpreting data, and finally, interpreting research findings. Source triangulation supported by data from three different techniques (interview, observation, and documentation) will be used to determine research validity. Then, the qualitative reliability technique provided by Gibbs as has been explained will be used to assess the dependence of the results for qualitative reliability.

## **CHAPTER FIVE**

### **RESULTS AND ANALYSIS**

#### **5.1 INTRODUCTION**

This chapter is the initial descriptive results of the primary data collected through the interview, observation, and documentation as detailed in the Research Methodology chapter. The descriptive analysis in this chapter initially focuses on presenting findings related to demographic variables, while the second part presents the perceptions of participants on the agency problem of microenterprise financing of BMT in Indonesia continued by the factors that affect the occurrence of the agency problem, the BMT program and strategy to minimise the agency problem in microenterprise financing.

The descriptive analysis in this chapter is based on 49 participants' data through interviews and qualitative surveys, the researcher also does observation to eight BMTs and collects some documents related to this research. The description will be divided into the following subsections:

- i. Expert validation result.
- ii. Pilot Study result.
- iii. Participants' profile in terms of demographics.
- iv. Participants' perceptions of microenterprise financing contracts.
- v. Participants' perceptions of agency problem existed in microenterprise financing of BMT in Indonesia.
- vi. Participants' perceptions of the factor that affect the occurrence of the agency problem in microenterprise financing of BMT in Indonesia.

vii. BMT Program in Minimising Agency problem in microenterprise financing of BMT in Indonesia.

viii. Strategy for Minimising Agency problem in microenterprise financing of BMT in Indonesia.

## 5.2 EXPERT VALIDATION REPORT

### 5.2.1 Characteristics of Expert Validation Participants

Characteristics of expert validation participants in this study include gender, location of work home base, field of expertise, length of study in the field of expertise, occupation, and work experience with the number of survey participants as many as seven experts. The following describes the characteristics of expert validation participants:

Table 5.1 Demographics of Expert Participants

No	Characteristic	Participants N = 7		
		Total Number	Percentage (%)	
1.	Gender	Female	4	57.1
		Male	3	42.9
2.	Work Location	Jakarta	2	28.6
		East Java	2	28.6
		Yogyakarta	2	28.6
		Riau	1	14.2
3.	Area of Expertise	Accountancy; Finance	1	14.2
		Islamic Economics; Islamic Business and Entrepreneurship	2	28.6
		Islamic economics	2	28.6
		Islamic Accounting	1	14.2
		Finance	1	14.2
4.	Length of studying in the field of expertise	21	1	14.2
		17	1	14.2
		10	1	14.2
		6	1	14.2
		10	1	14.2
		7	1	14.2

No	Characteristic	Participants N = 7		
		Total Number	Percentage (%)	
5.	Work experience	Researcher; Lecturer	1	14.2
		Researchers; Academics; Lecturers; Practitioners	1	14.2
		Lecturer	4	57.1
		Supervisor of Financial Institutions	1	14.2
		Practitioner	2	28.6

Source: The author

Table 5.1 explain the demographic data of expert participants. It can be shown that as many as four participants (57.1% of the total participants) were female while the remaining 3 experts (42.9% of the total experts) were male. The expert survey participants came from five cities spread over four different provinces, namely Jakarta, East Java, Riau, and Yogyakarta Special Region (DIY). Participants' areas of expertise include the field of Islamic economics expertise as many as two participants, two participants have expertise in Islamic economics and Islamic Business and Entrepreneurship, one expert has expertise in accounting and finance, one expert has expertise in Islamic accounting, and one expert has expertise in finance. The length of time participants has studied their field of expertise, namely one expert has studied his field of expertise since 2002, which means that the expert has studied his field of expertise for 21 years, and one expert has studied his field of expertise since 2005 or 17 years. Two experts have studied their field of expertise for 10 years, namely since 2012. The fifth expert has studied his field of expertise since 2013 which means that he has deepened his expertise for nine years. The seventh expert has studied his field of expertise since 2016 or for six years. Thus, each expert has deepened his expertise for more than five years, i.e., six to 21 years. For the work experience of the participants, the majority of whom are lecturers, namely four experts, one expert has work experience as a researcher and lecturer, one expert has experience working as a lecturer, researcher, and practitioner, and one expert has experience working as a policy maker at OJK. Most experts, as many as 71.4%, have work experience as

lecturers/researchers/practitioners/policy makers for eight to 11 years. While the remaining 28.6% have work experience as a practitioner for four to seven years. Thus, all experts participating in expert validation have more than three years of work experience, i.e., four to 11 years.

### **5.2.2 Expert Validation Survey Results**

The expert validation surveys collected in this study were obtained through the distribution of online surveys with the option of being able to provide survey feedback via email. The total number of validated question items is 29 with six question items related to problems and challenges related to agency relationships in microenterprise financing in BMT, 10 question items about BMT strategies in minimising agency problem in microenterprise financing, seven questions about the role of strategies carried out by BMTs. BMT in minimising the occurrence of agency problem in micro-business financing, and six question items related to solutions to agency problem in micro-business financing in BMT.

The expert validation survey was made by the researcher in the form of a google form while still providing a choice of file documents that can be downloaded in the google form and can be collected back via email. The selection of experts uses several criteria, namely 1) experts have expertise in economics/finance/accounting in general or Islamic economics/finance/accounting; 2) the expert has studied his/her field of expertise for more than five years; 3) experts have experience working as academics, practitioners, and/or policy makers related to BMT; and 4) experts have experience of working as academics, practitioners, and/or policy makers related to BMT for more than three years.

#### ***5.2.2.1 The Results of Expert Validation Responses***

The results of expert responses regarding whether the question items are valid or invalid can be seen in Table 5.2.

Table 5.2 Results of Expert Validation Responses

Question Items	Expert Response regarding whether the question item is valid (v) or invalid (x)							Review Results (Valid (V)/Invalid (IV))
	Expert							
	1	2	3	4	5	6	7	
1	v	v	v	x	v	v	v	V: 6 IV: 1
2	v	v	v	x	v	v	v	V: 6 IV: 1
3	v	v	v	v	v	v	v	V: 7
4	v	v	v	x	v	v	v	V: 6 IV: 1
5	v	v	v	v	v	v	v	V: 7
6	v	v	v	v	v	v	v	V: 7
7	v	v	v	v	v	v	v	V: 7
8	v	v	v	v	v	v	v	V: 7
9	v	v	v	v	v	v	v	V: 7
10	v	v	v	x	v	v	v	V: 6 IV: 1
11	v	v	v	v	v	v	v	V: 7
12	v	v	v	v	v	v	v	V: 7
13	v	v	v	v	v	v	v	V: 7
14	v	v	v	v	v	v	v	V: 7
15	v	v	v	v	v	v	v	V: 7
16	v	v	v	v	v	v	v	V: 7
17	v	v	v	v	v	v	v	V: 7
18	v	v	v	v	v	v	v	V: 7
19	v	v	v	v	v	v	v	V: 7
20	v	v	v	v	v	v	v	V: 7
21	v	v	v	v	v	v	v	V: 7
22	v	v	v	v	v	v	v	V: 7
23	v	v	v	v	v	v	v	V: 7
24	v	v	v	v	v	v	v	V: 7
25	v	v	v	v	v	v	v	V: 7
26	v	v	v	v	v	v	v	V: 7
27	v	v	v	v	v	v	v	V: 7
28	v	v	v	v	v	v	v	V: 7
29	v	v	v	v	v	v	v	V: 7

Source: Expert Validation Tabulation Data (processed by researchers)

From Table 5.2. most of the question items are said to be valid by the seven experts. However, several question items were declared invalid by expert four, namely items one, two, four, and ten. Based on the results of a review of the editorial and the content of the question item, it can be explained as follows: for question item one, editorially and content, the question item can be used by providing additional explanations of the word contract with the word contract and providing more specific

choices regarding the form of the cooperation contract used BMT. For question item two, editorial and content question items can be used by adding rankings related to problematic contracts and focusing on the top three to five rankings in exploring problems according to the context of the question item. For the fourth question item, two experts stated that the question item was almost the same as the previous question item. After the researcher reviewed the content of the questions, it can be said that the fourth question item can be combined with the third question item to minimise the number of questions asked to participants. For question item 10, expert four stated that the question item was invalid. However, from an editorial point of view, expert IV conveyed suggestions regarding changes to the editorial questions of the question item with the phrase "What factors does BMT have...." (See tabulation of expert validation expert IV question item 10). In terms of the content of the question items, expert IV said that the content was suitable for exploring and investigating agency problem in microenterprise financing at BMT.

#### ***5.2.2.2 Expert Response Results Related to The Editorial Question Items***

Regarding the editorial of question items, Expert I provided many inputs related to how the question items could be more easily understood by participants. This can be seen in suggestions such as "For this point, you should give an example of the agency problem closest to BMT activities. Because it is a shame if the respondent does not understand the definition of agency problem, the answer that will be given will be less precise." (See tabulation of expert survey data on expert I item question 3) and "The point is the same, for academic sentences such as asymmetric information, adverse selection, and moral hazard, the context should be made more familiar. If it is very needed, it can be asked separately if indeed the agency potential that occurs can be case by case and varied." (See the expert survey data for expert I, item 5). Expert I also criticise question items which are editorially and articulation almost the same as other question items. This can be seen from the advice given by expert I, namely "This item is the same as the previous point, to ask this it is better to give a familiar associative word about the problem of agency relations in BMT. Or through examples, to get more precise answers from respondents. (See tabulation of expert survey data in expert I, item 4).

In terms of editorial questions, expert II also gave some suggestions in terms of how the question items can be easily understood by participants, namely by explaining in advance the agency theory to participants. This is as stated by expert II, namely "It is necessary to explain to the BMT what the purpose of agency theory is" (see tabulation of expert data in expert II, item three) and "It is necessary to clarify beforehand to the BMT regarding the theory above" (see tabulation of data expert on expert II item five). In addition, expert two said that the question items were clear enough to be used as an instrument. This is as conveyed by expert II, namely "The question is quite clear" (See the tabulation of expert data on expert II questions 17 and 18). Expert II also gave suggestions related to editorial questions that were still incomplete, as expressed "How is the screening process (this sentence is not finished, what does filtering mean?)" (See tabulation of expert data in expert II, item 19). Expert III provides feedback related to editorials in a shorter language, such as "contract/contract" and "clear enough" for editorial suggestions on the first question item and "clear enough and easy to understand" for a sign of agreement regarding editorial questions on question item two and four. In responding to the editorial question item nine, expert III had time to ask whether the purpose of the question item was for SWOT analysis or not as stated "meaning this is a SWOT analysis yes" (see expert data tabulation on expert III item nine).

Expert IV said that question items one, two, and four, were invalid. From the editorial side, expert IV conveyed editorial suggestions for the first question item with "What contracts are used by BMT..." and did not explain specifically why the question item was invalid. In the question item, two experts IV said, "Too many questions. Uninterested, And problematic. The two can be different." which states the suggestion to pay attention to the number of questions that will be asked to participants to be able to achieve the research objectives or in other words the need to minimise the question items posed to participants. For the fourth question item, expert IV said that there was a repetition of the question item with the phrase "very similar to the previous question." In the tenth question item, expert IV conveys editorial suggestions for the question item, namely the words "What factors do BMT have...." expert IV conveys suggestions regarding the editorial of question items with short language such as "Even though they are similar, it is better to separate the questions for these concepts" for suggestions for separating question items on different issues in question item five and for changes in

wording for question items such as “.. owned by your BMT...” for editorial changes to question item Nine (see tabulation of expert data for expert IV questions five and nine).

Expert V provides direct editorial suggestions in the form of question items that have been adjusted by the editor. This is as stated "what financing contracts are used by BMT to finance microenterprises?", "Which parties are influential in triggering agency problem in microenterprise financing?", and "What strategies/approaches or programs what has been done by BMT in dealing with agency problem that occurs in microenterprise financing?" (See tabulation of expert data on expert V items one, six, and seven). On several question items that were editorially approved, expert V presented them with brief reviews such as "it is appropriate" and "it is appropriate" for question items 11 and 13. Expert V also provides advice regarding editorial questions related to customer terms editorial whether it is appropriate in the context of BMT with the expression “only the term customer is it used in BMT? Member or customer or partner?” on question item 14.

Expert VI provides feedback in the form of approval accompanied by input from the editor of the question item. This can be seen in the expression “The question is to see the form of a cooperation contract between BMT as a distributor of financing and customers as recipients of financing. There should be direct questions regarding the form of cooperation between BMT and agents or questions about what contracts are owned/used by BMT either for customers or other parties” and the phrase “the previous question does not reflect what kind of contract BMT has/used” (see expert data tabulation in expert VI items one and two questions). Expert VI approved whether there were suggestions/inputs related to editorial questions to improve participants' understanding and whether there was specific feedback on the editorial of the question item with the short phrase "nothing" (see tabulation of expert data on expert VI item three). In terms of editorial question items, expert VII provided several inputs including as stated, "Given a choice, Mudarabah, murabahah bil wakalah, deliberation or IMBT" and "Mentioned the specific program" (see tabulation of expert data on expert VII question items one and seven). Expert VII also provided feedback in the form of potential answers to the question items as conveyed "Explanation of the contents of the contract is not known to the customer" and "There is no input, for sure BMT always provides contracts that are more profitable for the BMT" (see tabulation of expert data

on expert VII question items four and nine). On several question items, expert VII also conveyed his agreement with the editorial of the question items with a brief statement, namely "No suggestions" (see tabulation of expert data on expert VII items five and eight questions).

### ***5.2.2.3 Expert Response Results Related to Question Item Content***

Regarding the content of the question items, Expert I provided a lot of input related to how the question items were relevant to be able to achieve the objectives of the question items. This can be seen in suggestions such as "This is what question, if you are exploring, it is better how or why questions. This is an opening question to explore at a later stage." (See tabulation of expert survey data on expert I item 1, question 1) and "Yes, by knowing the track record of solutions that have been carried out so far by BMT to overcome agency problem encountered." (See the expert survey data for expert I item seven). Expert I also provided advice regarding the content of several question items such as "Yes, you can, from an explanation of the contract definition and community preferences, it can provide an overview of agency potential and there may be cases related to existing contracts." And "The example given is only general, or it may give associative sentences which are generally connected with agency problem. In that way, God willing, the expected exploration will be answered" (see tabulation of expert survey data for expert I, items two and three). Expert I also criticised the content of the question items so that it can be more easily accepted and understood by participants as stated "Although there are already accompanying literature guidelines, in fact respondents do this voluntarily. Rarely can spend a lot of time. To get answers that are useful for research, it is better if words that are too academic are associated with words that are more practical and easily understood by the respondents." (See tabulation of expert survey data on expert I item ten).

In terms of the content of the question items, expert II expressed approval of the content of the question items with short expressions such as "Questions are quite clear" and some are accompanied by suggestions so that participants can more easily understand the questions as stated "It is correct, but editorially please adjust to the informant's ability to answer the questions", "Exactly, but first explain what agency theory is, because not all practitioners have a good background in mastering theory",

and “This question is accompanied by a related explanation to the BMT” (see tabulation of expert survey data on experts II item questions Nine, one, three, and 11). Expert III agreed with the content of the question items with short expressions such as "appropriate", "appropriate and appropriate", "enough", and "ok" (see expert survey data tabulation on expert III question items one, two, four, and five). Expert III also provided input, namely by giving answer choices to participants to make it easier for participants to answer question items as stated, "if we can give answer choices and empty answers for additional respondents because our respondents are practitioners who are usually lazy to think deeply" (see data tabulation). expert survey on expert III question item 10).

Expert IV stated that question items one, two, four, and ten were invalid. However, in the content of question one item, expert IV said that the question Is this question item appropriate and appropriate to explore and investigate agency problem in microenterprise financing in BMTs in Indonesia? Why or why not? The answer was, "Yes, because seeing the agency seen from the contract" where the answer expresses approval for item one question. For the second question item, expert IV stated that the question item can be used as a research instrument as well as providing input, namely "Yes, it is appropriate, it just needs to be deepened so that it is focused and not biased." In question item four, expert IV criticizes that the question item is a "repeat of the previous question" (see tabulation of expert data on expert IV item four) on question item 10, related to the content of the question item, expert IV states that the question item has correct and appropriate. From the four submissions of expert IV, although expert IV stated that the four question items referred to previously were invalid, in terms of content, expert IV stated that they agreed with the question items to be used as research instruments by submitting some of the inputs already mentioned.

Regarding the content of the question items, expert V conveyed his agreement the content of the question items with the phrase “it is correct. The questions are in accordance with the research objectives. Because you must know the financing contracts used to make it easier for the author in the analysis ", it's appropriate. Because the information obtained from this question will be the main discussion in the title of this research, and "It is appropriate. The answers to the questions will be the material (data) in the discussion of this study. (See tabulation of expert data on expert V items one, two, and three questions). In terms of the content of the question items, expert VI

provided criticism and suggestions on how the question items could be more easily understood by participants, as stated "The question is not appropriate because it is focused on exploring BMT cooperation as a financing distributor with customers as financing recipients, so it does not reflect directly a form of cooperation between BMT and agents.", "If I do not misinterpret this question, which is a general question, it needs to be placed at the beginning. These questions are relevant to dig deeper into the general problem of microenterprise financing distribution.", and "These questions are relevant, but as input, there need to be initial questions to find out the parties involved in microenterprise financing" (see tabulation of expert data in expert VI). question items one, five, and six). In addition, expert VI also agreed on the question items with several expressions of agreement such as "The question is still relevant to obtain information about the challenges of cooperation with agents" and "The question is relevant" (see tabulation of expert data on expert VI questions items four and nine). Expert VII conveys approval of the content of the question items with short expressions such as "Yes, it is appropriate" and "It is appropriate" (see the tabulation of expert data on Expert VII for questions three and five).

Expert VII also conveyed potential answers to the question items posed with the phrase "Most MSMEs do not have bookkeeping" (see tabulation of expert data on expert VII item two). Expert VII also provided approval feedback as well as confirmation of the content of the question items with phrases such as "Yes, it is appropriate, because some BMTs have programs for groups." (See tabulation of expert data on expert VII item 11).

#### ***5.2.2.4 Changes to Question Items After Review of Expert Survey Results***

Based on the results of the review in terms of editorial and question item content, several things are the main notes of the experts, namely:

- 1) In editorial and content, 27 question items from a total of 29 question items can be used as research instruments by changing and adding several editorials and question content such as using the term "contract" for the term "contract", changing the term "customer" with the word "partner." " or "members in the context of microenterprise financing at BMT, simplifying

the editorial questions and providing additional information in accordance with the context of the question items to facilitate the understanding of research participants.

- 2) The fourth question item is combined with the third question item to minimise the number of questions asked to participants.
- 3) Because the fifth question item has been asked regarding the problems and challenges faced by BMT related to three agency problem, namely: asymmetric information, adverse selection and moral hazard, the eight-question item is focused on constraints from external parties related to agency problem in financing microenterprises in Indonesia. BMT.

The editorial changes for each question item can be seen in Table 5.3 below:

Table 5.3 Editorial and Content of Question Item Review Results

No	Initial Question Items	Conclusion on the Results of the Question Item Review	New Question Items
1	What kind of contracts does BMT use to finance microenterprises?	In editorial and content, question items can be used by providing additional explanations of the word contract with the word akad and providing more specific options regarding the form of the cooperation contract used by BMT.	What financing contracts/contracts do BMTs use to finance microenterprises? Why?
2	Of the many contracts that have been mentioned, which contract is the least desirable (by customer partners and BMT parties) and the most problematic? Why?	By editorial and content, question items can be used by adding rankings related to problematic contracts and focusing on problematic contracts and focusing	Of the several contracts that have been mentioned, which product or contract is less attractive to both members (customers) and BMT? Which contract is the most problematic (top three rankings)? Why?
3	What is the agency problem that has and/or often occurred in contracts used in microenterprise	In editorial and content, question items can be used by adding examples related to	Has there ever been an agency problem such as dishonest behaviour from customers, allocation of

No	Initial Question Items	Conclusion on the Results of the Question Item Review	New Question Items
	financing? How can this agency problem occur?	agency problem to make it easier for participants to understand the intent of the question items.	financing funds not in accordance with the financing contract, and/or manipulation of reporting partners' business results in contracts (contracts) used in micro-business financing? If so, how did it happen?
4	What are the challenges faced in agency relationships that have and/often occurred in contracts used to finance these microenterprises?	Question items can be combined with three question items.	The question items are combined with the three question items.
5	What are the issues and challenges related to the problem of asymmetric information, adverse selection and moral hazard in microenterprise financing in BMT? How can this problem occur?	In editorial and content, question items can be used by adding explanations related to the three problems asked, namely: "asymmetric information, adverse selection and moral hazard"	Relation to problems such as asymmetric information, adverse selection and moral hazard. Has it ever happened in the micro-business financing process at BMT? How could that happen?
6	What parties are influential in triggering agency problem in microenterprise financing?	In terms of editorial and content, question items can be used by changing editorially the words "what parties..." with the words "which parties are influential ..."	Which parties are involved / influential in triggering agency problem in micro-business financing?
7	What is the BMT strategy/approach/program in dealing with agency problem that occurs in microenterprise financing? Have all these strategies and/programs been implemented?	In terms of editorial and content, question items can be used by adding exploration related to constraints and track records of strategies that have been implemented.	What strategies/approaches or programs have been carried out by BMT in dealing with agency problem that occurs in microenterprise financing? What are the obstacles in implementing the strategy/approach/program? Has the strategy/approach/program been implemented optimally?
8	What are the obstacles and challenges faced by BMT	In editorial and content, question items can be	From an external perspective, what are the

No	Initial Question Items	Conclusion on the Results of the Question Item Review	New Question Items
	in implementing these programs? How do customer partners respond to the program?	used by focusing on constraints from external parties.	obstacles and challenges faced by BMT in implementing BMT strategies/approaches or programs in dealing with agency problem that occurs in microenterprise financing? How do customer partners respond to the program?
9	What are the strengths of BMT in overcoming agency problem in microenterprise financing?	In editorial and content, question items can be used.	What are the strengths of BMT in overcoming agency problem in microenterprise financing?
10	What opportunities does BMT have in overcoming agency problem in microenterprise financing?	In terms of editorial and content, question items can be used by simplifying the editorial and question content to make it easier for participants to understand.	What opportunities does BMT have in overcoming agency problem in microenterprise financing?
11	Does BMT also have group lending and joint liability programs? If so, what is the mechanism?	In editorial and content, question items can be used by adding explanations related to the context of the question.	Does BMT also have group lending and joint liability programs? If so, what is the mechanism?
12	Does BMT also have a social coaching program? if so, what is the mechanism?	In editorial and content, question items can be used.	Does BMT also have a social coaching program? if so, what is the mechanism?
13	What are the advantages and/or differences of this program with programs in other IMFIs or conventional microfinance institutions?	In editorial and content, question items can be used.	What are the advantages and/or differences of this program with programs in other IMFIs or conventional microfinance institutions?
14	How is the selection or screening process for BMT micro-business financing customers?	In editorial and content, question items can be used by changing the Editor the term "customer" needs to be adapted to the BMT context with the word "member" or "partner."	How is the selection or screening process for BMT micro-business financing partners?

No	Initial Question Items	Conclusion on the Results of the Question Item Review	New Question Items
15	Does BMT require a guarantee in providing financing for microenterprises? If yes, what is the form and mechanism for submitting the guarantee?	In editorial and content, question items can be used.	Does BMT require a guarantee/collateral in providing financing for microenterprises? If yes, what is the form and mechanism for submitting the guarantee?
16	What is the BMT strategy in dealing with micro-business financing customers who do not have collateral? Is there a policy for applying social security to BMTs? If so, how is it implemented?	In editorial and content, question items can be used.	What is the BMT strategy in dealing with micro-business financing customers who do not have collateral? Is there a policy for applying social security to BMTs? If so, how is it implemented?
17	What is the influence of the strategy undertaken by BMT in minimising the occurrence of agency problem in microenterprise financing?	In terms of editorial and content, question items can be used by simplifying the editorial and question content to make it easier for participants to understand.	What is the impact of the BMT program aimed at minimising the occurrence of agency problem in microenterprise financing?
18	What are some real examples of the success of the BMT strategy in minimising agency problem in microenterprise financing?	In editorial and content, question items can be used.	What are some real examples of the success of the BMT strategy in minimising agency problem in microenterprise financing?
19	To what extent does the screening process/mechanism applied by BMT have an effect on minimising agency problem in microenterprise financing?	In editorial and content, question items can be used by further clarifying the question item editor.	To what extent is the influence of the process/mechanism of selection/screening of financing partners applied by BMT in minimising agency problem in microenterprise financing?
20	How is the effect of liability on collateral (collateral) in minimising the occurrence of agency problem in microenterprise financing?	In editorial and content, question items can be used.	How does the liability affect the guarantee (collateral) in minimising the occurrence of agency problem in financing
21	What is the role of social collateral in minimising agency problem in microenterprise financing?	In terms of editorial and content, the question items can be used by re-examining the influence	What is the role of shared responsibility (social security) in minimising

No	Initial Question Items	Conclusion on the Results of the Question Item Review	New Question Items
		of social security on microenterprise financing.	agency problem in microenterprise financing?
22	How do group lending and joint liability programs have an effect in minimising agency problem in microenterprise financing?	In editorial and content, question items can be used by providing specific examples related to agency problem.	How do group lending and joint liability programs have an effect in minimising agency problem in microenterprise financing?
23	How does the social development program have an effect on minimising agency problem in microenterprise financing?	In editorial and content, question items can be used.	How does the social development program have an effect on minimising agency problem in microenterprise financing?
24	What are the strategies/programs that can be offered to solve agency problem in microenterprise financing at BMT?	In editorial and content, question items can be used.	What strategies or programs are offered by BMT to be a solution to agency problem in microenterprise financing?
25	To what extent does the screening process, the obligation to guarantee (collateral), and/or social security applied by the BMT play a role in minimising the occurrence of agency problem in microenterprise financing?	In terms of editorial and content, question items can be used by simplifying the redaction of question items.	How the process of collateral and social security applied by BMT can minimise "agency problem." On microfinance transactions?
26	To what extent can group lending and joint liability programs be a solution to agency problem that occur in micro-business financing at BMT?	In editorial and content, question items can be used.	To what extent can group lending and joint liability programs be a solution to agency problem that occur in micro-business financing at BMT?
27	To what extent can the social development program be a solution to the agency problem in microenterprise financing at BMT?	In editorial and content, question items can be used.	To what extent can the social development program be a solution to the agency problem in microenterprise financing at BMT?
28	To what extent can technology or system digitization minimise	In editorial and content, question items can be used.	To what extent can digitalization technology or systems minimise agency

No	Initial Question Items	Conclusion on the Results of the Question Item Review	New Question Items
	agency problem in micro-business financing at BMT?		problem in micro-business financing at BMT?
29	What are the suggestions for BMT's future strategy to address agency problem in microenterprise financing?	In editorial and content, question items can be used by exploring the most feasible suggestions to be carried out based on the situation in each BMT and reconsidering the use of the term agent in the context of micro-business financing at BMT.	What is the future strategy of BMT to address agency problem in microenterprise financing?

Source: Expert Validation Tabulation Data (processed by researchers)

Expert validation in this study was aimed at forming the first revision of the survey instrument based on seven experts in the field of Islamic economics and/or finance, especially related to agency problem in microenterprise financing in BMT. Having seven expert opinions provides detailed text on what should and should not be in the survey instrument to represent the question items that will be used to explore further data through interviews. As experts are carefully selected based on specific criteria, their opinions are valid and reliable based on their professional background. Expert validation was applied to the development of survey instruments, wording, and defining terminology for each research instrument item. Based on the results of the survey of experts, it was found that although four question items were declared invalid by one of the experts, after further exploring the opinions of the experts, it can be said that editorially and content, 27 question items out of a total of 29 question items can be used as a research instrument by changing and adding several editorials and question content. The main input suggested by experts regarding the question items that will be used as research instruments is that certain terms related to problems, theories, and agency relations need to be conveyed in simpler language that can be easily understood by research participants who will become the object of research. interviewee. In

addition, the same or almost the same question items can be combined into concise, concise, clear questions, and represent some of the question items.

### **5.3 PILOT STUDY REPORT**

In the realm of qualitative research, face-to-face interviews have been the dominant interview approach. Telephone interviews have been prevalent during the previous two decades. Other interview approaches can be implemented because of the fast expansion of new communication channels such as e-mail and chat boxes (Opdenakker, 2006). In this pilot study, we used two interview methods, namely face-to-face interviews and online interviews using Zoom meetings. One of the informants also gave written interview answers in Microsoft word and then continued with online interviews using Zoom meetings to reconfirm the answers given. We started by asking participants to “give a response regarding microenterprise financing to BMTs.” We continue by asking questions related to "contracts/contracts used in micro-business financing" then the researcher continues with more specific questions related to agency problem in micro-business financing in BMT. agency problem in micro-business financing in BMT.” During each pilot interview, we asked using a semi-structured dialogical approach each participant's opinion about:

- Agency problem in microenterprise financing in BMT
- Factors that affect the occurrence of agency problem in microenterprise financing in BMT
- BMT program in dealing with agency problem in microenterprise financing in BMT.
- Strategies offered to minimise agency problem in micro-business financing in BMT.

The pilot study involved a rapid thematic analysis of each interview, fully transcribed by a research assistant who was then rechecked by the lead author and then

data coded using NVivo. For future studies, we will have all interviews transcribed by a dedicated transcription team and our research team will analyse the data (1) using the NVivo software to manage the data and (2) apply the case study method. We will analyse a team. At least three members of our team will be extensively involved in analysing the data (lead author, transcription team, and data analysis validator team to improve the validity and reliability of research results).

## **Results and Discussion of the Pilot Study**

The most important results from our pilot interviews were: (1) finding the perspective and narrative insights provided by the five pilot participants, leading us to believe that subsequent interviews will provide useful data to answer our research questions; (2) lead us to expand our target sample group to ensure we achieve maximum variation in perspective; and (3) assisting the research team to refine interview techniques for qualitative case study research. Based on the observations of the pilot interview conducted by the principal investigator, several things need to be improved in the interview protocol:

- Ask very direct “Why, What, how” questions. Simple questions that are easy to understand are best. Avoid turning the interview into a conversation because the real question tends to get lost or become unclear.
- Unlike other forms of interviewing, we need to develop an interview protocol with fixed questions and a fixed sequence.
- In asking questions, you want them to identify their intentions (ask, for example, "What are you trying to get there?").
- In asking questions, you look for differences and similarities (e.g., “How is it? different/similar to what you said earlier?”).
- Avoid characterising what you think they have said (methods used in other forms of social science research, such as grounded theory and phenomenology, where these methods are used to ensure the interviewer's

interpretation matches the speaker's intended meaning). Wasting interview time analysing their responses means you are not spending enough time asking them to explain additional meanings. Take the time to investigate the "What, When, Why, and How" of what they have just said, and the differences and similarities with other things they have said.

- Avoid anything that could appear to lead (e.g., "Sounds good.>").
- Consider using the question "How do you know that the results are accurate (or useful)?"
- Make sure the questions cover the "new" aspects of the "new" "problems and solutions" and/or the "new knowledge generation."
- Closing questions should ask them to summarise their definition and/or understanding of the central phenomenon.

The resulting interview protocol is provided as Appendix A. Ultimately, the use of a case study research methodology will help us identify the qualitatively different ways these three groups of informants conceptualise knowledge and experience. However, based on pilot interviews, we have reason to believe that participants will provide insight on topics that include:

Five people participated in this study whose demographic characteristics are listed in Table 1. In addition, after analysing the data, 4 categories, 16 subcategories, and 154 initial codes were obtained (Table 5.4).

Table 5.4 Demographic Information of Interview Pilot Study Participants

No	Variable	Group	Frequencies
1.	Gender	Male	4
		Female	1
2.	Education	Bachelor's degree	2
		Master's degree	2
		Doctoral degree	1

3.	Experience	Academics and practitioner	3
		Practitioner	2

Table 5.5 Data Coding Results of Interview Pilot Study

No	Category	Subcategory	Codes
1.	<b>Agency problem issues and challenges</b>	Adverse Selection	Selection SOP, Field survey, partner character, commitment, community that can accept new policies, partners not compatible with policies, manipulation of information, changing market orientation, poor governance, disbanding, limited energy, limited HR, unhealthy management, creating opportunities, conflict of interest, competition, personal guarantee
		Ex-ante moral hazard	Mentoring, partner character, discipline, partner discipline, partner openness, dishonesty, fraud, dark opportunities, limited HR, culture
		Post-ante moral hazard	Business reporting, recording, understanding the essence of the contract, dishonesty, reporting manipulation, trust, fraud, business reporting, recording, default, bad loans, red off
2.	<b>Factors that affect the occurrence of agency problem</b>	Implementation of the contract	Interested contracts, contracts according to Sharia principles, ijarah, istishna', buying and selling without wakalah, product models, mudarabah, murabahah, musawwamah, musharakah, qardh, qardhul hasan, wadi'ah. Gharar, higher risk, risk of untrustworthy partner
		Management staff behaviour	Limited energy, fraud, unhealthy management, limited HR, poor governance, commitment
		Partner/member behaviour	Partner character, discipline, partner discipline, partner openness, commitment, dishonesty, understanding the essence of the contract, manipulation of information, culture, bad loans, risk of untrusted partners
3.	<b>BMT program in dealing with</b>	Implementation of Sharia principles	Contracts according to Sharia principles, greater effort, ordinary executives, law, contract innovation,

No	Category	Subcategory	Codes
	<b>agency problem</b>		contracts of interest, contracts according to DSN standards, buying and selling without wakalah, urgency of needs, wakalah not proper, contracts such as conventional banks, insurance, administrative costs, evidence, fines, gharar, product models, operations according to Sharia principles, higher risk, risk of untrustworthy partners
		Selection	Record financing, regulations are not too strict, SOP selection, field survey, not burdened
		Guarantee	Fixed value, default risk, bankable, default, partner violation, vehicle BPKB, SOP, personal guarantee, competition, group loan, social program
		Supervision	Mentoring, pilot assistance, business reporting, recording, business development, IT-based services, instalment payments, savings, approach to members, personal touch, billing division, service, experience, professional management, risk management, strengthening of HR, monthly reminders, repeat orders
		Training/coaching program	Strengthening HR, capacity building, employee performance appraisal, personal in touch, social programs, training costs, synergies between institutions
		System digitization	Digitization, IT-based services, cashless, fraud
		4.	<b>Strategies for dealing with agency problem</b>
Synergy between institutions	Development program, Islamic financial literacy, capacity building		
Monitoring system	Personal in touch, operational according to Sharia principles, assistance		
Service	Selection SOP, incentives, bonuses, discounts, financing SOPs		

**Agency problem issues and challenges** – Has there ever been an agency problem such as dishonest behaviour from customers, allocation of financing funds not in accordance with the financing contract, and/or manipulation of reporting partners' business results in contracts (contracts) used in micro-business financing? If so, how did it happen?

Our expert pilot interviewees indicated agency problem in the following ways:

"Yes, that's right, sister, there are many opportunities so we don't control it, then if you bought it, you said you want to buy 10kg, did you really buy 10kg, said the price is 10k, is it really 10k? the risk is changing the story, right..." "Looks like this, maybe the wakalah still had the risk of an untrustworthy partner not according to the promise, right, and sometimes we can't control that when the money has been handed over, the power is with him, right? After we try to practice e-Sharia in a truly Sharia manner, we can minimise such risks because we are really buying and selling goods that we deliver real goods, the products are according to what he asked for, and what has been known together e... the next risk if the credit sale is selling credit, it's on the customer's discipline to pay in instalments according to the promise now... we're right now the risk is there, but no Thank God the NPF Figures were suppressed after the 2015 hijrah, so there are positive side effects that we can see by putting them into practice..."

**Factors that cause agency problem** – From internal and external factors, what are the influencing factors in triggering agency problem in micro-business financing at BMT?

Regarding the factors that cause agency problem, the pilot interview informant conveyed the following:

"The Sharia principle is on partner discipline, partners' commitment to fulfilling their obligations, indeed NPF cannot be 0 [laughs] it can be reduced to a minimum, but if we are farmers or tracers who are stuck in traffic, yes, there are some problems, yes, but far sometimes the business has various risks, maybe because of the changing business environment, so he may experience traffic jams, like yesterday we had the covid case, the financing had just started, how long does the lockdown take, they can't do anything, right [heem] that's why the NPF is high, but there's also maybe their unprofessionalism in managing it, but overall if we look at the NPF there is a significant decrease, so we can judge after that it could lead to a decision that is not wrong, because we also see... Actually, we think that from the start it has been selected, the character, people who

want to follow our contract are generally people who understand Sharia business practices, so there is sufficient knowledge there and usually it's e... linear with character, so it's more trustworthy, so what process is selected [laughs] If people understand Sharia, is it true that the quality of religion increases so it's safer" "From there, does this person want to do that. Is it true or not? just looking because the others are not acceded. We do have to do various kinds of analysis and we as marketing people, we must think negatively first, it's up to him, it turns out the bell he's positive, thanks. So, from that, we will not take all the Partners to be our customers, all of us, and even everywhere, yes, but the point is that now it's more about sister's ability, not because of character, because yesterday someone said goodbye. Assalamualaikum warahmatullahi wabarakatuh, I beg your permission, this new child is sick, if you like, I'm very sorry, I will guarantee to add BPKB to that much, I replied, we replied from the office. Even people who can't afford to pay have good character, but in terms of ability, in the future, right, he's in arrears, right, he's in arrears and will be a problem with financing problems, one of which is for the value of arrears in my own office, Ms. it's at 1.2%. small Actually it's still so small and it's small and it works better than before, if it used to be a lot I who is stuck is a character like that if now it's jammed because there are so many abilities like that..."

**BMT program in dealing with agency problem** - What programs have been carried out by BMT in dealing with agency problem that occurs in microenterprise financing? What are the obstacles in implementing the strategy/approach/program? Has the strategy/approach/program been implemented optimally? Related to the BMT program in minimising the agency of the informant explained as follows:

"The strategy carried out by BMT ... in dealing with agency problem that occurs in micro-business financing, such as accommodating the needs of micro-businesses that have been changed from nominal to goods needed by partners so that disbursement can be easily and optimally benefited according to the needs of potential partners. BMT ... does not give money, but in the form of goods needed by the prospective partner." "The guarantee is very important, that's why we put in the soup, there must be a guarantee because, uh, the guarantee is the only tool to save us all, so on the partner's side, if you can't pay the default and the debt must be paid before death, there are two guarantees That's done, on the BMT side, the security has come out from the guarantee too, so the role is very big, yes and it will make people feel more responsible, that's for sure because there is a guarantee, oh BMT and it's easy, how come we fence it, for example, like this, I need it ee borrowed BPKB for the name behind it So if he has arrears, we don't give him, then the certificate Mas wants to borrow, we want to sell it, sell it first, the anus is all done, so it's a fortress, so it's a function of its role, eh, the guarantee is right there ... And it's like there was once a husband and wife whose husband was a high enough civil

servant like it was an ordinary household, eee a month I met a survey after That's the contract to pay the first instalment, the second instalment, come to BMT, ask to change the name of the financing so that it's a wife. Why, Mom, if I die, it gives me goosebumps, Ma'am, two months ago I just found a survey that I'm still healthy. That's true, that's how a wife wants her name to be free from debt, just transfer it to me like that. if it's for us instead of changing like this, it's not a problem for us, thank God, it's good that they are here but on the other hand, we already don't use insurance, right at BMT ..., it's a bit insurance and if it comes later there will be a statement that the wife's calibre will fall then automatically even though the husband's name is gone, it still goes to the wife, she already has nothing else besides the guarantee, so it's still a few months later, she still can't afford to pay the instalments, after a few months she handed it over to BMT to sell it at that time like That's sister and that's the role of the guarantee to solve everything Even though it was very tight at that time, Ma'am, between him and her paying off. Asking for a discount with the car being sold, it's very thin, very demanding. Well, that's one soup, it's also rated at 70%, that's a moving object. at any one time it increases it will shrink like that.”

**Strategies in dealing with agency problem** - What is the future strategy of BMT to address agency problem in microenterprise financing? The following statements by informants, although not explicit, can represent answers regarding solutions that can be offered to BMT in the context of mitigating the risk of agency problem:

"The strategy of BMT going forward to overcome agency problem in micro-business financing is in the form of making special Standard Operating Procedures for submissions intended for micro-business financing." "Strengthening human resources from BMTs, strengthening human resources, especially spirituality and human Resources competency capabilities, then both partnering with educational partners, be it OJK, KNEKS or universities, yes, who can provide education and that can also be done not only to prospective customers but also to the BMT. BMT also upgrades knowledge like that..."

This pilot study has shown that the case study approach can produce valuable results for academics/researchers/practitioners/policy makers to identify issues and challenges to agency problem and offer solutions to these problems. In this pilot study, interview collection has led to a revision of the sample group as well as the interview questions and protocol. Lessons learned about the answers obtained from the informants highlighted the need to develop an interview protocol with relevant questions in a language that was easier for the informants to understand. This can help interviewees

explain their intentions and expand the details they provide to help uncover meaning during the analysis. It is important to investigate the "What, When, Why, and How" behind participants' initial statements and ask them to describe the differences and similarities between their statements.

## 5.4 PROFILE OF PARTICIPANTS

This section describes the profile of participants participating in this research through a demographic profile of the basic characteristics of the respondents.

### Demographic Profile

Table 5.6. provides demographic characteristics of the 49 respondents.

Table 5.6 Demographics of Research Participants

No	Characteristic		Participants N = 49	
			Total Number	Percentage (%)
1.	Gender	Female	8	16
		Male	41	84
2.	Institution	Government	4	8
		University	3	6
		BMT	38	78
		BMT Association	4	8
		BMT Practitioner	37	76
3.	Work	Lecturer/Researcher	2	4
		Lecturer/researcher and BMT Practitioner	2	4
		BMT Association agency staff	4	8
		Government agency staff	4	8
		Chairman / Supervisor / Main Manager of BMT / director (head) of the division	16	33
4.	Division	Manager of financing division / related divisions	8	16
		Non-financing manager	3	6
		Finance staff	19	39

No	Characteristic	Participants N = 49		
		Total Number	Percentage (%)	
	Other	3	6	
5.	Length of work	< 1 year	4	8
		12 years old	5	10
		35 years old	5	10
		6 - 10 Years	6	12
		> 10 Years	13	27
		No Mention	10	20
6.	Areas of expertise	Economy	5	10
		Sharia Economics	7	14
		Administration and Accounting	3	6
		Sharia Accounting	1	2
		Sharia Finance/Financing	19	39
		Other	14	29
		No mention	29	59
7.	Another experience	Academics	4	8
		Businessman	3	6
		Manager	1	2
		Banking	2	4
		Others	4	8
		No mention	29	59

## 5.5 OVERVIEW OF RESEARCH DATA

Word frequency is a feature for recording and calculating the most frequently mentioned words from data that has been input into NVivo. Word cloud is the result of visualization of these word frequencies. It can be seen in Figure 5.1. the most frequently mentioned words from this research data. Among these words is "member, financing, cooperatives, Sharia, financial guarantees, and character."





## 5.6 TRIANGULATION DATA AND TECHNIQUES

In this study, the triangulation of data sources supported by data from various techniques were used to strengthen the validity of the research data. Data triangulation was carried out by taking data from several data sources, namely from several related parties including BMT practitioners, practitioners from BMT associations or related institutions, expert academics, and regulators. Research also takes data from several sources from each BMT, namely supervisors, chairmen, managers, and/or financing divisions. The research data also supported by data from various techniques by collecting data using several methods. In this study, data were collected using several methods, namely interviews, observation, and documentation. The triangulation of data supported by data from various techniques can be seen in Figure 5.4.

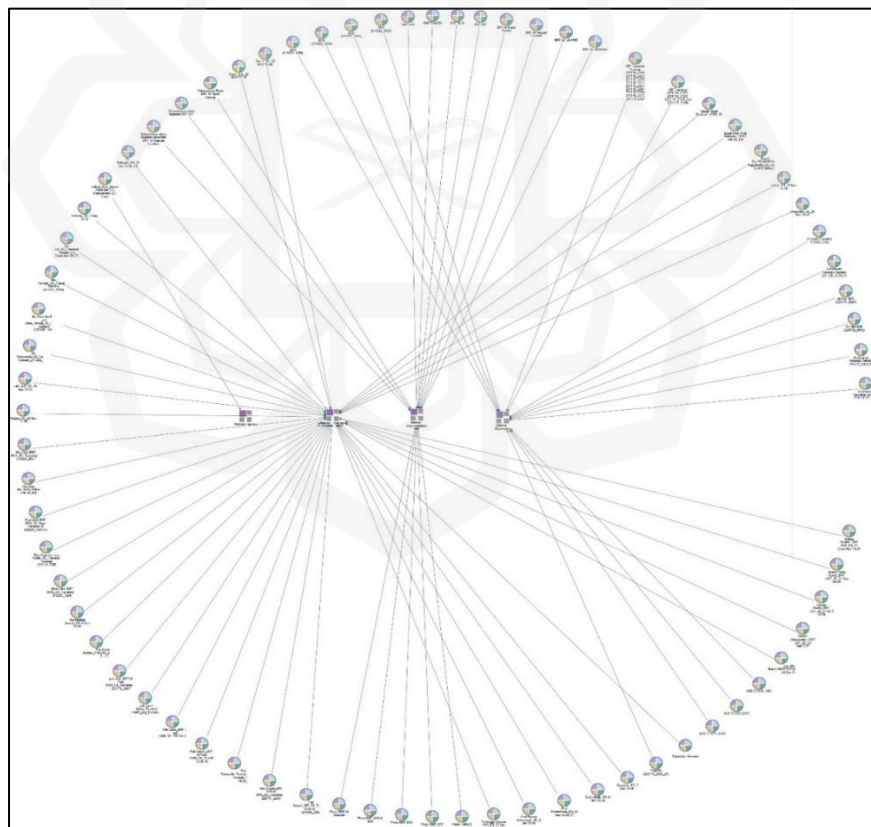


Figure 5.4. Circular Diagram of Triangulation Data and Technique

The Circular Diagram of Triangulation Data and Technique is an NVivo tool for visualizing and analyzing the integration of numerous data sources and methodologies in a qualitative research project. It employs triangulation, which is combining several methodologies, data sources, or perspectives to improve the validity and dependability of study results. The figure depicts several data sources or approaches as circles, with each section indicating a data source or method employed in the study. It depicts how these sources or procedures overlap or relate to one another, exhibiting the convergence of data and methodologies. Interviews, surveys, observations, documents, and techniques such as thematic analysis, coding, or pattern matching can all be used as data sources. The circular diagram for triangulation involves inputting data into NVivo, constructing a diagram, assessing intersections, improving validity, and reporting the findings. It gives a straightforward and easy manner to demonstrate how the study's many components work together to provide a full analysis.

## 5.7 DATA CODING RESULTS

NVivo is a software tool for categorizing and subcategorizing qualitative data. This research employs in vivo coding for first-cycle coding, which entails interpreting and comprehending the data to determine participants' language and terminology. This process involves establishing codes, evaluating them, categorizing comparable codes, assigning descriptive descriptions, constructing subcategories, and improving them. Second-cycle coding aims to integrate and arrange the first codes and categories to find bigger patterns and themes. This procedure includes evaluating categories and subcategories, recognizing trends, creating theme categories, and fine-tuning hierarchies. The final analysis and documentation entail fine-tuning and changing the categories and themes to appropriately reflect the data and record conclusions. The coding process produces subcategories and categories which can be seen in Table 5.7.

Table 5.7 Categories and Subcategories Data Coding Results

No	Category	Subcategory
1.	Agency Problem	Adverse selection
		Members do not disclose information
		Dishonesty

No	Category	Subcategory
		Misuse of fund allocation
		Report manipulation
		The character is not good
		Payment failure
		Inability to pay in instalments
		Able to pay but the desire to pay is difficult
2.	Factors Affecting Agency problem	Type of contract
		Selection process
		BMT HR
		Afraid of not being accepted
		Violating the SOP
		Urgent needs
		Whether or not there is a guarantee
		System weaknesses
		Risk management is starting to loosen up
		Communication is not smooth with members
		Character is not good
		Lack of supervision
		Capacity is not enough
		Economic problems
		Family conflict
		Education is done with small talk
		The implementation of the contract is not in accordance with Sharia
		There was intention at the start
		There is still room for evil
		Communication is not smooth with members
3.	Program to Minimise Agency Problem	Increasing the capacity of BMT HR
		Synergy and cooperation
		Development, Mentoring, and Training of BMT Members
		Improvement of institution governance
		Program innovation
		The use of Information Technology
4.	Strategy to Minimise Agency Problem	Capacity development of institution HR
		System digitization
		Governance
		Community education
		Synergy and cooperation
		Regulation
		Specific models or methods
		Member education
		Supervision

Source: Main Research Data

## **5.8 MICROENTERPRISE FINANCING IN BMT**

Based on the results of research data, there are several contracts used by BMT to finance micro-businesses, namely: Mudarabah, Musharakah, Murabahah, Ijarah, Ijarah multiservice, IMBT, Qardh, Qardhul Hasan; and Istishna'. However, in this research, we will focus on the five contracts most widely used in BMT, namely murabahah, mudarabah, musharakah, ijarah and qardhul hasan contracts.

### **a. *Murabahah Contract***

The murabahah contract is the contract that is most in demand by both members and the BMT. The reason this contract is most popular is because this contract is considered the easiest and simplest to implement, has a certain rate of return, and has lower risk. For BMT members, the murabahah contract is also considered simpler because basically, this contract uses the concept of buying and selling which is widely known by the public and is easier to understand. This contract is also one of the easiest contracts in terms of calculation and is in accordance with the needs of micro-entrepreneurs.

The types of murabahah contracts commonly used by BMTs are murabahah and murabahah bil wakalah. Murabahah contract is a sale and purchase contract with direct procurement of goods. In the mechanism, members submit a need for an item, then BMT provides the item, and then the member purchases the required item from BMT with a payment system in instalments. Another type of murabahah is the murabahah bil wakalah contract. In this contract, the member submits a need for an item, then BMT gives the member representative authority to spend on the item, and then the member provides proof of confirmation of the purchase of the item (usually using a purchase receipt). For items where there are not too many items, such as vehicles and machinery, the contract used is a murabahah contract. A murabahah bil wakalah contract is typically used for large quantities of goods sold in retail environments, particularly in stores with numerous items. Even so, there are BMTs that try not to use murabahah bil wakalah contracts. This is because the murabahah bil wakalah contract is more at risk of irregularities, namely members not being transparent about the use of financing funds. In other words, there is dishonesty among members in the allocation of financing funds,

whether they are used by other people or allocated for other needs that are not in accordance with what is stated in the contract.

On the other hand, in terms of technical obstacles related to distance, time and energy, BMT also has limited HR to carry out murabahah contracts without wakalah. The various activities and responsibilities of each HR are not proportional to the number of HR and existing members. Furthermore, implementing murabahah contracts to procure goods needed by business actors is a challenge, especially for the needs of certain goods where purchases are usually made at night, such as vegetable, food, or wet food sellers. Some of these obstacles make the majority of BMTs still use murabahah bil wakalah contracts.

#### **b. Mudarabah Contract**

The Mudarabah contract is one of the contracts that is widely used in BMT, although this contract tends to be unpopular, especially by BMT. In terms of the amount of profit sharing, if the prospective member's business and the financial statements of the business are clear, the profit-sharing system in the mudarabah contract is easier to practice. For business capital needs, this contract is seen as a contract that is very suitable for the needs of business members. However, based on the results of a qualitative research survey, the mudarabah contract is in second place as the least popular contract in BMT. This contract is seen as a contract that is difficult to implement due to the need for financial reports by members who are incidentally low in business bookkeeping literacy so that in practice it will be difficult to determine the amount of profit based on the profit-sharing ratio. In addition, this contract also has a higher risk if a loss occurs, it will be borne by the BMT which is authorised as shahibul maal.

An example of implementing a mudarabah contract is a contract for a project in the form of mudarabah canvassing. The form of implementation is that members have a business in the form of food catering and then BMT provides capital for the catering business activities and funds are returned after the catering order is completed with a profit-sharing system as a short-term financing model. Another type of mudarabah used is mudarabah muthlaqah where the BMT provides funds for business capital needs to

members and then there is a calculation of the percentage of profit sharing according to the agreement at the beginning. Members are interested in this type of contract because they are free to use the funds provided by BMT for their business needs. However, the implementation of this type of mudarabah contract requires financial reports from the members of the BMT. In practice, mudarabah contracts are used for short-term financing (commonly called temporary financing) for a duration of one or two months.

Given the condition of micro-business actors who on average do not keep financial records, for business profits, they use business profit projections for example for a nominal financing of IDR 1,000,000, the projected profit is IDR 10,000, - or even some BMTs implement a system of giving sincerely according to predictions business profits from financing members. The mudarabah financing ceiling can be up to Rp. 50,000,000. Based on experience, there are members of business actors who are waiting for certain funds to be disbursed, and in these conditions, these members apply for financing to the BMT first for business purposes, and then the funds will be returned after the funds are withdrawn. The awaited liquid with a certain percentage of profit sharing in accordance with the agreement at the beginning of the contract (usually looking at the amount of capital they receive). In terms of profit predictions, BMT provides information based on the experience of other members who apply for financing with the same contract. Some BMTs also use a system to calculate profit sharing for mudarabah financing.

Technically, members enclose sales results each month, and then BMT calculates estimated turnover per month and profit sharing according to the agreement at the beginning. Another model that is applied is the mudarabah sliding system, namely mudarabah with a decreasing nominal amount of return in the sense that it is not flat. In practice, for a sliding mudarabah system, if a member pays off in the middle of the time, the member will suffer a loss, so BMT provides an alternative to using a murabahah contract with a flat payment system. However, in the case of IMFIs<sup>2</sup>, this reality conflicts with regulations from the central IMFIs<sup>2</sup> office which requires that financing above IDR 20,000,000 must use a sliding mudarabah system. Some BMTs choose a safe path by using alternative contracts other than mudarabah. This is because some of these BMTs feel that the community is currently still not ready to use contracts with profit sharing systems such as mudarabah and musharakah.

On the other hand, some BMTs also try to conduct training and mentoring for members of micro-entrepreneurs, especially in terms of recording financial reports and bookkeeping of their business. This is because, if the implementation of the mudarabah contract is only based on profit projections, there are fears that there will be costs that have not been fulfilled or there are components of income that have not been included in it. Therefore, financial reports are important in implementing contracts with a profit-sharing system, one of which is mudarabah. Even so, financial records are still a separate issue, especially for micro-entrepreneurs who are not used to recording and/or not all are able to do so.

### **c. *Musharakah Contract***

Musharakah contract is a financing agreement that is widely used in several BMTs in Indonesia. However, based on qualitative survey data, this contract is seen as the most difficult contract to implement. The reason why this contract is difficult to implement is because there is cooperation in terms of capital between two parties, namely BMT and members, which will be complicated in terms of calculations, each party has the right to intervene in capital and business management. In addition, there are issues related to the financial recording of micro-business members which will increase the level of difficulty in calculating the results of musharakah contracts.

Furthermore, there is a guarantee for the honesty of BMT members who are partners in the musharakah agreement, the existence of which is still doubtful. However, some BMTs still use this contract, including for member financing requests which are deemed more appropriate to use a musharakah contract. For example, to finance a convection project, a member receives an order for a uniform sewing project from a school with a project value of Rp. 200,000,000, -, then the member can collaborate with BMT with a certain proportion of capital each using a musharakah agreement. The calculation of profit sharing is in accordance with the proportion of each capital. After the project is completed, members make a profit report from the project and submit it to BMT. In other BMTs, the determination of the profit margin rate refers to the lowest profit rate. For example, for the capital of IDR 1,000,000, -, the lowest average profit is IDR 10,000, -, then BMT takes a rate from the lowest profit, for example IDR 1,000, -.

If within a certain period, a member does not get that much profit, then there is a risk that must be shared or at least the member does not pay a profit margin.

#### **d. *Ijarah Contract***

The *ijarah* contract is one of the contracts used by BMTs to finance microenterprises. This contract is used for financing in the form of services or benefits such as renting a business place. In practice, members apply for *ijarah* financing to the BMT and once approved, the BMT will pay the cost of renting the space directly to the landlord. Another type of *ijarah* contract that is practised is the multi-service *ijarah* used for renovating a business place, for example.

#### **e. *Qardhul Hasan***

The *qardhul hasan* contract is used by BMT to provide financing for small traders belonging to the *dhu'afa'* group who need it. BMT provides financing with the same amount of refund without any additional financing burden. Meanwhile, if members provide more returns, the *infaq* will be calculated and entered social funds. In practice, in this financing, several cases are still found, such as the use of funds not being in accordance with the contract and members not returning the funds lent. In essence, the issue of members not repaying funds is acceptable. However, to educate members and the community in general, it is necessary to provide special guidance accompanied by assistance in implementing this agreement to achieve the main objective of financing in the context of empowering the poor.

### **5.9 FINANCING ANALYSIS ON BMT**

In measuring the feasibility of financing, BMT uses criteria that are almost the same as those used by banks, namely the 5C analysis, namely Character, Capacity, Capital, Collateral, and Conditions. Even though it uses the same criteria as those used by banks, in practice, BMT is not as strict as banks in using these criteria measures. In other words,

there is still room for dispensation from BMT in selecting financing members. This is because the essence of BMT's presence is the empowerment of community market segments that are considered unbankable. If the criteria for measuring financing are the same as those in banking, then the function and essence of BMT's presence in society becomes questionable. Interestingly, BMT also uses other measurement criteria, namely the conformity of financing transactions with Sharia rules. A more detailed explanation regarding the analysis of micro-business financing at BMT is as follows.

#### **a. Character**

In selecting prospective financing members, the BMT usually prioritises people who are already known by the BMT, who are usually old members of the BMT. Even if not an old member of the BMT, the person is already familiar with or is known by BMT officers, especially officers who make daily visits to members, such as in markets and the surrounding business area. Some BMTs recruit employees from the local community with the consideration that they already know or are known by the local community so that it will be more effective and efficient in the selection process for potential financing members.

The financing track record is also considered in the selection process to find out the character of the member in the previous financing. BMT also utilises connections with BMT or other financial institutions in detecting the character of prospective members. Environmental surveys and information gathering with local people were also carried out to obtain more detailed information related to prospective financing members. On the other hand, the communication skills of financing officers are needed so that prospective members are willing to be open in conveying valid information and can know the honest character of members. Character analysis is a very important thing to do because this can affect the smooth return of financing funds. An educative approach also needs to be carried out to meet the character size in this financing. Some BMTs use this educative approach by providing guidance to members and prospective financing members to prepare and change towards good character.

## **b. Capacity**

In terms of the capacity principle, BMT tries to see the ability of prospective financing members to return financing funds which is linked to their ability to manage the business and earn profits. The more sources of income, the greater the ability to return financing funds. The principles of capacity include managerial capacity, financial capacity, and technical capacity. Managerial capacity namely how experienced the prospective financing member is in managing the business and how the business has developed while being handled by the person concerned. Financial capacity is the ability of prospective members to manage the Company's finances. Several aspects analysed include whether the prospective member's business management has poor financial management skills, whether the business performance is not good but has prospects for growth, and whether the business's finances could worsen at any time. Technical capacity is whether there are things that disrupt the continuity of the business or whether technically the business is facing uncertainty regarding the supply of raw materials.

In carrying out business capacity analysis, BMT uses the same method, namely business verification with known prospective members or by verifying people around them who are already known or know potential members. Daily visits to prospective members through the savings and financing pick-up service can also provide information to financing officers regarding the business capacity of prospective financing members.

## **c. Capital**

In this principle, BMT will see the adequacy of capital owned by prospective members of the financing in running their business. Capital analysis is carried out by studying the net worth of prospective members of the financing seen through BMT observations. BMT obtains information from daily visits, surveys of places of business, information from local people, and/or the track record of savings owned by prospective members.

#### **d. Conditions**

In the condition's principle, BMT will try to see the financial stability of prospective financing members. The aim is to predict future business prospects along with financial capacity information. Then the BMT will also predict the risk of possible failure to pay from prospective financing members. If the financial condition of the prospective member of the financing is unstable, the BMT will not immediately reject the application for financing but will verify it from other ways such as looking at the track record of the prospective member, whether there are recommendations from trusted people, and/or seeing whether there is a guarantee for the financing.

#### **e. Collateral**

Collateral is a principle in the form of physical and non-physical guarantees given or owned by prospective financing members. The guarantee given should exceed the amount of financing and its validity will be examined first by the BMT. Guarantees are important in the selection process for prospective members of BMT financing, which are the unbankable community as a protector from the risk of default. Collateral principal analysis intends to bind the prospective financing members' seriousness in running a business and paying financing obligations besides that it is also a second way out in the event of default. Even so, most BMTs still provide flexibility in terms of the type and value of financing guarantees.

There are two types of collateral used by BMT, namely social collateral and physical collateral. Social collateral includes personal guarantees in the form of recommendations from trusted community leaders and BMT internal staff. physical guarantees in the form of vehicle certificate, certificates of land ownership rights or building use rights, or in the form of any assets owned such as electronic goods owned by prospective members of the financing. Guarantee standards applied by BMT on the one hand provide convenience for members, but also in some cases can be a source of other problems in the financing settlement process later. BMT also offers unsecured financing, usually reserved for old BMT members who are known and have a known track record of business and/or financing by BMT. The nominal value for this type of

financing is usually small within a certain period such as 100 days and is usually reserved for market traders who are visited every day by BMT officers.

#### **f. Constraints**

This principle attempts to look at the limitations and obstacles that cause a business to not be implemented due to certain conditions such as place, climate, society, etc. Based on research at eight BMTs in Indonesia, there are two constraints faced by prospective BMT financing members, namely 1) the COVID-19 pandemic conditions which occurred for three years, namely from 2020 to 2022 which had an impact on the businesses of prospective members because there were restrictions on community activities. including buying and selling activities, BMT transactions, and changes in people's habits for online buying and selling transactions, one of the issues is that prospective BMT financing members are older people who are not technologically literate enough to be able to sell online; and 2) the fire incident that was experienced by several prospective BMT financing members.

#### **g. Sharia Compliance**

Sharia compliance is one of BMT's superior criteria in the selection process for prospective financing members. In implementing these criteria, BMT places emphasis on implementing contracts in accordance with Sharia principles. However, not all BMTs use these criteria in their financing. For example, when implementing a murabahah contract, some BMTs try to use a murabahah contract without a wakalah with a mechanism for procuring goods with the consideration of avoiding harm that arises from the existence of a wakalah in the murabahah contract.

Some BMTs also pay attention to whether the goods being transacted comply with Sharia provisions. In implementing the contract, the understanding of prospective members and the conformity of the contract with Sharia principles is also emphasised. Including Sharia compliance, BMT does not charge certain administrative fees to protect against usury components in financing. Furthermore, some BMTs who felt they

were not ready to use mudarabah and musharakah contracts, transferred financing to contracts that they thought could implement them, such as murabahah contracts. Not only avoiding things that are prohibited by Sharia, some BMTs even pay attention to things that are makruh, for example, the prohibition on smoking, which is makruh according to Sharia teachings. Makruh is a non-binding Shariah requirement that does not result in punishment but may be disrespected (Muhamed Ali, Md Ariffin, Rosele, Abdul Hamid, & Mohd Noor, 2022). It is described variously in usul fiqh literature and may be appreciated by those who abandon it. Makruh has four meanings: banned, Nahy al-Tanzih, tark ma huwa al-awla, and ambiguous and syubhah in relation to its position as haram. It is impossible to conclusively identify makruh as halal, although a medium category may be established, incorporating makruh's status (gray area), with a clearer rationale required.

### 5.10 AGENCY PROBLEM EXISTING IN MICROENTERPRISE FINANCING OF BMT

Most informants discussed agency issues in micro-business financing at BMT. It can be seen from Figure 5.5. that illustrates agency problem existed at each BMT.

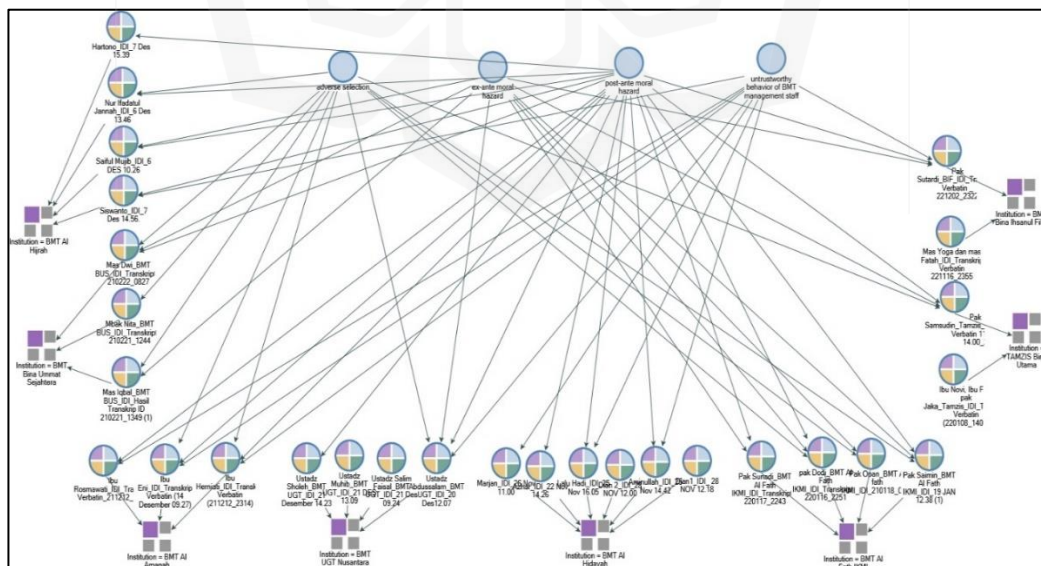


Figure 5.5 Forms of Existing Agency problem

It can be seen from Figure 5.5. that there is agency problem in the eight BMTs where the research was conducted, namely adverse selection, ex-ante moral hazard, post-ante moral hazard, and based on experience, untrustworthy behaviour has been found on the part of BMT management staff. A more detailed explanation regarding this matter will be explained as follows:

**a. Adverse selection**

One form of agency problem that occurs in micro-business financing which is an unbankable community is errors in selecting prospective members for BMT financing or adverse selection. Adverse selection can occur when there is information that is not conveyed in the selection process for prospective financing members. Failure to convey this information can occur because members do not convey information that is in accordance with actual conditions, especially during initial communication with marketing, who are BMT staff who usually interact directly with members or prospective members. In this condition, prospective financing members submit their financing application does not match their actual needs or cover up information regarding the presence or absence of other dependents such as social gatherings, debts, and/or other financing. This is as stated by participant (IPBG2):

"Yes, there was a social gathering, any social gathering, he said I don't have any dependents except here. "Later, we'll investigate, and we'll find out about the neighbours or people around us."

This condition of not conveying information by members also sometimes extends to filling out the financing application form as one of the financing conditions. Members do not fill in information regarding income and other dependent data according to actual information. As explained by participant (IPBC1):

"Yes, it's possible, right? Miss, we have a financing form, the contents of which are also something like, how much income has he had in his business, since when, how much has his expenses, for example, how much is the husband's income, which means how much is the wife, are there other dependents or not, are there any assets? there are savings like that. It's possible that from there, sometimes it's incomplete, isn't it, sis, whether it's a member who deliberately doesn't fill it in and it's there or

what, sometimes we can't, for example, it turns out he or that member has other savings, for example in a bank or something, it's automatic, right? It's written, we don't know either, sis, it's like that, it turns out that when you became a member you had financing here, then when you were billing, it turned out that there you met with ee or other marketing people who were also billing like that, even though as far as we know, they didn't have financing, so when you filled in the application, it was empty. it's just that we're just here. "That's right, there are also ladies who are rich like that and in the end, it automatically affects the instalments."

Another case occurred during a financing survey where a member also took out a loan or financing at another financial institution which in the future could have an impact on the member's capacity to return the financing funds. This is as stated by participant (IBPB4):

"... there are also things like that, in fact most of them when surveyed, the term is really clear, everything is good, sometimes members actually make their own mistakes, for example they have taken it at ... but also taken it elsewhere, so they sometimes ... Sometimes people don't control their objections, so it has an impact on us too, some people take it, for example, to Institution A, Institution B, there are also loan sharks, sometimes it also has an impact on us."

Members sometimes only convey information openly after experiencing problems with financing refunds such as not running smoothly or being stuck. Therefore, the next survey by the BMT account officer is important to dig up further information in the context of BMT financing analysis. This is as stated by participant (IBPB4), namely:

"Sometimes they don't want to convey it to marketing in the field, sometimes the members just say it's for business capital, sir, but sometimes they don't want to admit it, if it's already been said, there's an AO and there's a survey."

Another case is the act of falsifying the conditions for applying for financing which started from submitting information that did not match the actual conditions, which was carried out deliberately by new BMT members. Adverse selection is also prone to occur in unsecured financing provided by BMT for nominal financing, for example, financing with a ceiling of IDR 1,000,000 -. This unsecured financing is usually given to members who are known to meet certain criteria. BMT will usually

analyse the location and length of business of prospective financing members. For market locations that BMT staff usually visit, there are usually many BMT members who are already known to BMT and have a clear or permanent place of business. This is different for traders who open stalls in certain locations outside the market, usually not having a fixed place of business, so they are expected to be able to move. Regarding the length of business, some prospective members do not convey information that does not match the existing reality. In this case, it is necessary to have an accurate financing analysis before providing financing funds to the prospective member. This is as stated by participant (IBPB4):

"If it's in the market, it's detected because we have a lot of members, but if it's outside the market, sometimes if the survey isn't detailed, sometimes that's the case, ma'am."

"... yes, because if it's not a place where the term is used for hanging out, it's a place to be sure, sometimes it's hard to track it down. "It's like seasonal traders, there are research traders like that, we charge them, and it turns out the next day they're not there anymore, so it's a hassle."

Based on this explanation, there are different risks between members of micro entrepreneurs who have a permanent or non-fixed place of business. Microenterprises that have a non-fixed business location have a higher risk where the business location may move and its whereabouts will be difficult to detect. In the condition that the member has received financing funds from BMT and then moves to a place of business to a location unknown to BMT without providing good information to BMT, this will have implications for moral hazard if the member deliberately runs away with funds from BMT. On the other hand, if the member accidentally moves without notifying BMT, asymmetric information will occur in this case which could also have implications for moral hazard if the member then deliberately does not notify BMT about the change in place of business.

#### **b. Ex-ante moral hazard**

The financing case that occurred was a misuse of financing fund allocation by financing members. Members do not convey this information to BMT and when problems occur,

new members convey information openly to BMT. Misuse of the allocation of financing funds includes some funds being used or lent to other parties, for example to relatives. This is as explained by participant (IBPA4):

"He..eh, after that there was information that after the financing problems, the member, what's his name, was opened up"

"Just conveyed the money yesterday, some of it was for shopping, some of it was lent to a relative, well, sometimes it's like that when there's a financing problem, members say it like that, they open it themselves. Why? Maybe it's because the money wasn't paid by his brother, so that's it."

This problem also occurs in qardhul hasan contracts where BMT does not know whether the financing funds are used for business activities. This is as stated by participant (IBPA4):

"In the field, there are also those, sometimes with no guarantees of any kind, it seems as if borrowing is easy. In the end, I didn't want to return it even though we looked at the cases. Is it true that the money was used for what his business was called? If, for example, the business uses it, the business goes bankrupt. Well, it's okay if we don't return it, that's the right of the poor, poor people. Because we use funds from zakat, infaq shodaqoh, that is for the poor, which means that even if we don't return it, it's okay, it doesn't really mean that because it's his right, right? We just need to know how to educate it like that."

Cases of ex-ante moral hazard also commonly occur in financing with murabahah bil wakalah contracts where BMT authorises financing members to spend on the business needs they propose even though sometimes there is assistance from BMT as an effort to minimise irregularities. Members use funds in whole or in part for other purposes, not in accordance with the provisions of the contract. In practice, members also sometimes manipulate receipts for purchasing goods given to BMT. This is as explained by participants (IBPA2 & IPBC3):

"Actually, the information regarding ee will go from us to them. Later, there will be an officer who will arrange it, so put the wakalah, yes, he has been approved and he already has a schedule for disbursing funds for the wakalah contract. During the process of the wakalah contract, it was explained what the wakalah contract was and what had to be done, so

after it had been completed, it was done again, right? It had been explained, it had been given a form like that. Well, sometimes when I say character, even though he has been told that he has been told that the terms of the contract will be spent according to what is in the form, well, if he has character then just stick to what is proposed. Used for other purposes where financing becomes a problem."

"When asked about the funds, I asked for it to be like this, but later when it has been disbursed, the funds have decreased, usually the allocation is for other things like that. If it's in the application, it's for school purposes, but if it's usually for paying off debts, it's not suitable for other things like that."

"When it comes to business capital, it's like that, sis, so not everything goes into business capital."

### **c. Post-ante Moral Hazard**

Cases of moral hazard in BMT include reporting business results that are not in accordance with actual conditions, where reporting business income is not in accordance with real conditions, which has an impact on the calculation of instalment obligations which are also not in accordance with real conditions. In mudarabah financing, for example, there needs to be real finance because what will be shared is the net profit of the business as the basis for calculating the profit-sharing ratio. In this condition, many members manipulate financial reports in the hope that the profit sharing based on the agreement ratio given to BMT is smaller than what should be given. This is as explained by participant (IBPE3):

"The first thing we see is in mudarabah financing, for example, BMT provides financing to micro-businesses, this is a challenge for us, because sometimes members cover up financial reports, first of all, what financial reports are covered, the results, so the mudarabah has to issue financial reports real because what will be divided later is the net profit, so what is the ratio, there are many members who are smart enough to cover it up, ahh later if I show my financial report with big profits, then BMT who got it ok, well like that, it's better not to cover it up by engineering financial reports, so the profit sharing is small so that the ratio given to BMT is small, this is the first,"

This case can also happen to two parties, namely the financing member covering up business profit information and the BMT when there is a loss in the member's business, the condition will be manipulated as if the member's business did not suffer a loss. This is as stated by participant (IR3):

"... there. Yes, that's right. With his partner, he covered it when he made a profit, that's how it was. Made a loss. Well, on the bank side, when customers make a loss, they have to make a profit (laughs). It could happen, it's possible, yes. Because the second one is very rare, ma'am. When banks or Sharia financial institutions force customers to remain profitable, that is a very, very, very... eeeee... very minimal opportunity. Why? "Yes, if you make a profit, the customer can't pay the profit, that's what I mean, ma'am (laughs)."

Micro-business financing at BMT uses several contracts which have different risks of agency problem. Based on information from survey respondents, musharakah contracts are the least popular contracts because they are the most difficult to implement and have the greatest potential for agency problem. This is as explained by participant (IA1):

"... Well, that means that all contracts have a very high possibility of permanent agency. What needs to be researched is how big the agency potential is in each contract, but it turns out that the existing theoretical reference is that musharakah is the highest compared to mudarabah or murabahah, so why musharakah? It's high because there is a tendency for people to be pestered in their business, they will do what is called deviant behaviour, which is what is called in the Qur'an, so when that person is shirkah then one of them is trying to betray the other."

The case of post-ante moral hazard occurs because of asymmetric information which causes adverse selection and after the financing is running it has an impact on the occurrence of ex-ante moral hazard. This condition does not only happen to new financing members but also occurs to old members who have applied for financing several times and may also have loan or financing obligations outside the BMT. Due to the lack of ability to pay all the dependents, the members finally fled to another area. In this case, BMT has the right to take the assets guaranteed by the member. However, in several cases where movable collateral was used, the collateral was also taken away, sold, or pawned to another institution by the member and some even falsified ownership documents for assets pledged to BMT. This is as stated by participant (IBPG3):

"... Yes, you can't see it, there are those who have taken it many times and have paid it off many times, taken it again, paid it off, taken it again, but maybe a lot of it has been taken outside, so they can no longer cover it all, they run to another area, sometimes there is a handle here, the term is collateral. "You can't take the guarantee, like if it's a vehicle or something below."

Agency problem is also prone to occur in unsecured financing which BMT usually provides to members who are well known and have a clear business with a nominal financing amount that is not large, such as IDR 1,000,000. In this type of financing, members with bad character can take the financing funds away after disbursement. Members who have bad character can be seen from the members' abnormal movements, such as deliberately avoiding them, especially when approached by BMT officers to make financing instalment payments. When asked by BMT officers regarding the suitability of business reports with real conditions or financing instalments, members with bad character usually find lots of excuses and try to divert the conversation or in other words do not openly convey real information to BMT. Members with good character can be trusted and loyal when it comes to paying financing instalments. On the other hand, there are members who can pay but do not have the will or deliberately delay paying even though they have reached two or three call positions. This is as stated by participant (IBPD4):

"...Even when there are indications of problems, they are discovered. Because when I replaced AO due to illness, a member had funds. When I was still far away, I had not yet reached this person's block, that person was still there, I saw that he was still there. If the block were laid out straight like that, there would be blocks, right? Yes, the person would still be there. When I got to the block, the person was gone. So, it is not just one time, it's the same the next day."

#### **d. Untrustworthy behaviour at Human Resources BMT**

Based on research results, several cases of untrustworthy behaviour among BMT employees were found in several BMTs in Indonesia, including employees collaborating with members in terms of financing, for example, members applied for financing of IDR 2,000,000 - in the member's name even though in reality, some of the funds (for example 50% of the financing funds or IDR 1,000,000 - are used by BMT

employees. Another case is the dishonest act of BMT managers who hold BMT funds in accounts in their names. On the other hand, there are offers from certain financial institutions to store funds in their institution with attractive promotions, there are certain prizes as bonuses for storing these funds. In this case, there are two possibilities that can occur, namely embezzlement of member funds and embezzlement of bonus gifts for member funds stored in certain financial institutions which are the rights of the fund owners, namely members. This is as explained by participant (IBPD1):

“How many branches do you have in 100? Ok, now who are your branches with, well, if you have the head of the branch, then there could be an opportunity for this to be taken, not to mention if the bank gives you the lure that if you deposit funds with us, sir, we will give you a TV and give you a refrigerator. "We gave him a cell phone. Even though the money that was inside was the institution's money, the gift given by the bank should have belonged to him, who belonged to the institution, but his friend took it as personal property, so that's the system."

Another case is that BMT financing staff conspired with members in providing financing funds that did not comply with existing procedures. This is as stated by participant (IBPG2):

"... if the personnel are good from within, everyone is trustworthy, people's money won't go anywhere, if we throw it into financing and the problem is only there, well that can be resolved, because the problem is clear, but if it leaks, for example, I am in the financing department, trusted by my mother as Manager, I'll give it on behalf of this and that, I have a customer, because I'm in cahoots with you, there's a requirement that the limit is only 5 million, in the end you might need 50 million, he's on behalf of other people, right? I'll take ten. million with different people's names, there were maybe 10 people, when they were billed for bad debts, the mother herself managed this 50 million, well that's where the problem as an employee is problematic too because colluding with customers is not a procedure, and that can also cause problems, right, automate it This 50 million is stuck. "This also means that we have the most problems outside, when we are out with friends, it turns out the problems are the same,"

In profit-sharing-based financing, BMT employees cover information about members' business losses, so they do not get scolded by their superiors, and in murabahah financing, marketing or BMT officers cover the cost price of the financing object. Other cases include embezzlement of financing deposit funds or savings of BMT

members, including through manipulation of member financing instalment data, manipulation of member financing data input in the system, member funds being taken away by cooperative administrators, or BMT employees providing financing payment bailouts to members without providing confirmation to BMT. This is as explained by participant (IR3, IBPE3, IBPH3):

"... then for BMT which covers it, well, this is often conveyed to friends, please convey it, don't cover up information related to financing, for example like this, the member bought a motorbike like that, a used motorbike or a new motorbike, sometimes marketing, our human resources cover the price principal, even if any item covers the principal price, for example the principal price of ten million is not conveyed, this is the first time..."

"... the term agency problem in financial institutions is to cover up... to cover customer losses is also possible. What for? "So that at the bank the reserves are not high and so that at BMT so that he doesn't get scolded by his boss, that's what ma'am (laughs)."

"... So, there are a number of people in the management who don't take the instalments properly and don't take much, and then there are civil disputes about whether the financial registers don't match the real ones, so that's the rather serious problem that's happening to us."

Based on the explanation above, the agency problem that exists at BMT can be seen in detail in Table 5.8.

Table 5.8 Agency problem that Exists in BMT

No	Agency problem	Evidence	Contract
1.	Adverse selection	The selection process for prospective members for BMT financing is prone to errors due to a lack of accurate information.	Mudarabah Musharakah Murabahah Ijarah Qardhul hasan
2.	Ex-ante moral hazard	Members of BMT falsify purchase receipts and misappropriate money for non-contractual uses.	Murabahah bil wakalah Qardhul hasan
3.	Post-ante moral hazard	Members reporting business results incorrectly impacts instalment obligations, and members with bad character may	Mudarabah Musharakah

No	Agency problem	Evidence	Contract
		take away funds after disbursement in small financing amounts.	
4.	Untrustworthy behaviour	Employees collaborate with members in financing, applying for funds in their names. BMT managers hold funds in personal accounts, and financing staff conspire with members to provide funds that do not comply with procedures. Profit-sharing based financing and murabahah financing cover business losses. Embezzlement of funds can occur through manipulation of instalment data or savings.	Mudarabah Musharakah Murabahah Ijarah Qardhul hasan

Source: Main data (processed by the author)"

## 5.11 EXPLANATION OF WHY AGENCY PROBLEMS STILL OCCUR AT BMT

The existence of agency problems at BMT in providing financing to microentrepreneurs is a particular issue for BMT, which carries out its activities based on Islamic principles. Based on research data, the occurrence of agency problems in microbusiness financing is due to several main factors, namely HR factors and BMT governance, as well as factors originating from BMT members. BMT HR and Governance factors include the selection process, BMT HR capacity, weak supervision system, and poor BMT Governance. while BMT member factors include the character of the member or prospective member and the member's lack of understanding of Sharia finance. A more detailed explanation regarding this is as follows:

### 1) Human Resource Factors and BMT Governance

#### a. Lacking accuracy in financing analysis

One of the main causes of agency problem is inaccurate financing analysis. Several financing analysis criteria generally applied by BMT are almost the same as the criteria used by banks, namely the 5 C principles as explained in the discussion of micro

financing analysis at BMT. However, in practice, BMT provides a lot of leeway regarding the financing analysis criteria so as a result there are still agency problem in micro-business financing at BMT. This is a dilemma for BMT, where most of its members are unbankable people. Many prospective members have poor capacity and ability to pay, and the large number of members' debt obligations are only discovered later, when the funding application has already been approved by BMT.

On the other hand, members' business conditions that suddenly experience problems are also often found. Members experienced a sudden decrease in income due to layoffs, the COVID-19 pandemic, a quiet market, and businesses downturned. Members migrated to other areas, members died, businesses went bankrupt, and family conflicts impacted income. Natural conditions like disasters and fires also contributed to the decline. BMT is known to be more lenient in terms of financing analysis compared to other financial institutions. On the one hand, this has become one of the BMT icons that is more popular with many groups, especially lower middle-class people. However, on the other hand, the convenience provided by BMT could become a boomerang for BMT if there are a lot of financing problems.

Another issue, namely the mastery of knowledge related to financing analysis among BMT officers, is also still questionable because BMT HR do not necessarily have areas of expertise that suit BMT needs and some BMTs even have HR with low education. Under these conditions, sometimes information mining cannot be carried out perfectly by BMT (for example: the survey is not very detailed) due to a lack of scientific mastery of financing analysis. Apart from that, the absence of a loan or financing data detection system in microfinance institutions (such as BI checking in banking) is also an obstacle for BMT in selecting prospective financing members. Lack of communication skills to members also results in members being less open to conveying information in detail and in accordance with actual conditions. On the other hand, prospective financing members are usually in need of funds and the mindset of not wanting to bother, the important thing is that the funds can be disbursed is a trigger factor in hiding information.

Whether or not there is collateral for financing at BMT also raises its opportunities because the system for collateral obligations at BMT is still very loose.

BMT still offers unsecured financing at a certain nominal value. The criteria for guarantees in financing which must have collateral are still very loose, so this creates many opportunities for misuse of funds and embezzlement of collateral by BMT financing members.

The main problem in providing financing is how to get financing members who have good character and can be trusted. In this case, financing analysis plays an important role in extracting accurate information because sometimes information cannot be obtained clearly. Knowledge about the character and business capacity of prospective members is important because this could potentially lead to financing problems in the future. This is as explained by participant (IBA4):

"The main problem with financing is how to get customers whose character is good, then whose business capacity and ability to pay are good, smooth and profitable, right? Because in that aspect, if you don't detect it clearly, you could meet people whose character is less trustworthy. or not trustworthy, maybe in terms of character you meet someone who is trustworthy but it turns out that in terms of extracting the information or what you get from your business, it's not perfect so it could turn out that in terms of raw materials, there are limitations or there are lots of things that unexpected information is obtained which are only discovered after financing has occurred. , so there is the potential for problematic financing or instalments."

A member's capacity to repay financing installments may also be impacted by purposefully applying for loans to loan sharks without the BMT's knowledge. This is because members may have other obligations, such as loans to loan sharks, which are typically traps and have become a daily necessity for members. In other cases, the large number of dependents that members have, such as lottery club responsibilities, debts, and/or financing in other institutions can also trigger ex-ante and post-ante moral hazard.

#### **b. Limited capacity and quantity of BMT human resources**

Several problems related to BMT HR can trigger agency problem at BMT, including limitations in the number, time, and energy of BMT HR in carrying out duties to serve financing members, the number of which may not be comparable to the number of

existing BMT HR. HR at BMT sometimes also carry out several tasks, such as financing officers who also carry out several tasks such as surveys, financing analysis, visits, and instalment pick-up, which requires skill and time to implement. Moreover, as BMT gets bigger and develops, communication between BMT and members becomes less and less smooth so BMT's closeness to members fades, which will also have an impact on the BMT's emotional closeness with members.

Regarding the quality of HR, not all BMT HR have skills in financial management. On the other hand, financing officers at BMT usually also have certain achievement targets every day, week or month. The BMT staff service process is more focused on collectability, not the quality of financing transactions. This is as explained by participant (IBPF4):

"On average, BMT friends are in the service process, if I look at it, the service process is more about collectability."

This can trigger a lack of professionalism and even lack or lack of trustworthiness in BMT HR in carrying out their duties. To achieve the target, officers can lower their financing analysis standards, resulting in the potential for financing problems due to inaccurate analysis. Furthermore, after financing is provided, some officers may be negligent or lazy in collecting the financing instalments, which can have an impact on financing irregularities. Lazy officers are individuals who are not totally involved or motivated, which causes problems with handling finance installments. This lack of effort can lead to lost payments, financial irregularities, and other inefficiencies. Officers should be aggressive and thorough in their duties, since a lack of care in collecting payments from borrowers might result in unfavorable consequences. Lazy officers are individuals who are not totally involved or motivated, which causes problems with handling finance installments. This lack of effort can lead to lost payments, financial irregularities, and other inefficiencies. Officers should be aggressive and thorough in their duties, since a lack of care in collecting payments from borrowers might result in unfavorable consequences. To minimize undesirable results, police must be proactive and diligent in their obligations.

Misunderstandings between internal BMT employees also sometimes occur where each one accuses the other employee of doing something wrong or not being good. The large number of matters as well as the limited capacity and quantity of BMT, especially those that handle financing, are also obstacles for BMT which do not have time to cross-check to increase the accuracy of financing analysis. This is as stated by participant (IBPC1):

"Yes, sis, especially if, for example, almost every day there will definitely be dropping, sis, we will definitely want to, for example, if we want to control this one, there is already another application and then we have to prospect again, not to mention the other bills which are there every day. "The collecting process, sis, maybe in my opinion it's difficult to control everything because it's a bit passive, so what's the problem with the manager, for example, he's the one who takes care of the financing, it's also limited, for example, the comparison is the one who submits it, yes, that's also in terms of time, it might be. Yes, I have a lot to take care of (laughs)."

### **c. Lack of BMT supervision**

Lack of supervision is one of the main causes of agency problem. This is as conveyed by participant (IBPH3):

"Oh, it's like banking, that's my reason. At the centre here, thank God, up until now, it seems like there hasn't been anything serious like that. Only yesterday at the branch experienced it. From there, we audited management that wasn't right. It turns out, wow. Turns out it's all broken like that [Laughs] even though we all have a system, but yesterday the supervision wasn't strict enough, right, it wasn't ours like that? There are friends there. So, there are several people in the managers who didn't take the instalments properly and didn't take much. "Also, there continue to be civil disputes over whether the financial registers do not match the reality, so that is a rather serious problem that is happening to us."

In many cases, agency problem occurs due to a lack of assistance from BMT from the time the contract is executed until the financing is completed. Members use it to pay debts such as online loans, for example, this can happen if the member is not accompanied in carrying out the contract. Apart from that, poor communication between BMT officers and funding candidates or members can trigger asymmetric

information. After the contract is carried out, there needs to be ongoing assistance to financing members until the financing is carried out in accordance with existing provisions. On the other hand, BMT supervisory HR also need to understand financial bookkeeping so they can carry out their duties correctly. This was because cases of agency problem were discovered, one of the causes of which, after further investigation, was that the financing supervisory officer did not understand financial bookkeeping.

On the other hand, BMT supervision also requires HR who understand financial bookkeeping because if there are errors, they can give a warning so they can be corrected immediately. This is as stated by participant (IBPH3):

"Yes, there is a gap, there is a gap for yes, indeed, supervision and routine supervision, rather detailed supervision, indeed, if you don't know bookkeeping, you are asked to supervise, you don't know that, so people who know that know about bookkeeping, who know how the financial structure goes, where is that because yesterday "At that time, BMT, before us, ACC managed things and so on, yes, I'm not that kind of person, but I don't really understand bookkeeping and so on, so the one who managed it was the one who caused problems like that [Laughs]."

#### **d. Poor BMT Governance**

Several issues related to BMT governance include poor and professional management, one of which is due to system weaknesses where some BMTs still use manual systems. The system also sometimes still provides opportunities and occasions for agency problem to occur. In this condition, as a Muslim, one's faith and understanding can be a dampener to avoid untrustworthy behaviour on the part of both the management and BMT members. When an audit was carried out on the BMT, problems were detected, such as lack of strict supervision, problematic management and embezzlement of instalments. This is as stated by participant (IBPH3):

"... there's something really serious, but yesterday at that branch experienced it, because of the management that wasn't right, we audited it, wow, it turned out everything was broken like that [Laughs] even though we all had a system, but yesterday there was really not enough supervision. That's strict, isn't it, it's not ours, that's right. There are friends there. So, there are some people who manage it incorrectly when they take the instalments, don't take a lot, and then there are civil disputes

about whether the financial register doesn't match the reality, so that's a rather serious one. That's the problem that's happening to us."

The risk management of some BMTs is also becoming looser because BMTs no longer focus on community-based but more on the public. This is as conveyed by participant (IBA3):

"... BMT is a community base, so what should it be like in the past? There were several high-ranking officials in the past, several high-ranking officials at KNEKS in the past said that BMT had to be small, maybe that's not what I meant when I said that BMT had to be a community base, it had to be clear that it was serving Whether the community has a small or big problem, it's their own fortune. With a community base, they will understand their stakeholders better so that risk management can also be better adjusted. Well, this is at a time when risk management is starting to loosen up because it is not just focused on a few communities but serves the public like a bank, so if a bank exists it is assisted by some big infrastructure like the BI Checking facility, but if BMT still doesn't have that kind of infrastructure, right? That's how it exists, right?"

There is no standardization of financing SOPs at BMT. SOPs for BMTs vary from one BMT to another. However, there are still BMTs that do not have specific SOPs for their financing activities, so the implementation of financing is still not standardised regarding the technical implementation. For example, the problem that arises is that because there are no fines for late financing, some members are not disciplined in returning financing funds. Some BMTs already have financing SOPs, but they are not implemented perfectly. In practice, financing staff add or subtract provisions in the SOP so that implementation is not appropriate and violates the existing SOP. On the other hand, the financing staff do this because of the dilemma of having certain financing achievement targets while finding members according to the SOP is not easy. This is as explained by participant (IBPC2):

"So far, the SOP from the centre has actually been very good and there has been anticipation from all sides, so in my opinion, as long as the branch still uses the SOP 100%, God willing, it will be safe. If later there are problems, there may be SOPs that are not currently in place, for example, financing that is in accordance with the SOP of 50%, not adding it to 60% is not appropriate, and that also violates the important thing that we monitor the SOP from the centre, God willing, it will be safe from all aspects because The SOPs created are based on experiences from the field as well."

In terms of refunding financing funds, there is a due date on a certain date when financing staff usually visit members to make instalment payments. However, in cases where members do not pay instalments within the due date, the majority of BMTs do not issue fines as a form of warning to members. In this condition, BMT members sometimes underestimate not having to pay the instalments on time but deliberately delay payment.

#### **e. Lack of Sharia compliance in implementing financing contracts**

The implementation of the financing agreement should also be in accordance with Islamic Sharia principles. Non-compliance with Sharia in contract implementation can provide opportunities and opportunities for agency problem to occur. For example, in financing contracts, BMT provides funds directly to members and pays little attention to the type of financing contract used. On the other hand, there is no ongoing assistance in terms of implementing the contract and using the financing funds provided to financing members. This can provide an opportunity for fund allocation not to be in accordance with the contract. This is as stated by participant (IBPA4):

“Well, that is by improving compliance with Sharia contracts following the Sharia Council, which we must follow in operations. God willing, if you follow the Sharia Council's fatwas and agreements. Because indeed, to be honest, maybe our friends at other BMTs who are still there today gave us their money. The money is given to the open account, which is spent by the members. There are more members who shop like that because it's from the party's side. The members are really complicated, want this, want this. Even when there are old members, their business is good, they are a bit reluctant, why do I have to follow my shopping, we pay. That's quite a bit, maybe there's something like that, it's complicated or maybe there's a sense of embarrassment too, why would you buy the proceeds from a loan for financing like that, there are also those who object to that. But if we educate directly, then the contract scheme requires buying and selling, while buying and selling goods must be controlled by the BMT first and then discussed with the members. BMT does the shopping, then after shopping it sells to members. "Education like that, understanding of the Sharia, usury is a very serious sin, it's the same as adulterating one's own mother."

The absence of Sharia compliance can trigger agency problem at BMT. Several things related to Sharia compliance, namely inappropriate contract selection and weak

emphasis on contracts during surveys and the process of implementing financing contracts. This is as stated by participant (IBPA1):

"Usually, if there is a deviation, it is because we are weak in our contract, for example, we were the first to be weak in our emphasis during the survey, that is the basis for our weakness. because in the survey, we are this institution, we don't borrow money, if we do borrow money, that means we are not Sharia, right? That is the basis for when there is a deviation, when we survey there should be an emphasis "what do you want to buy or what do you want to pay for, that should be the emphasis..."

An example is the use of the murabahah bil wakalah contract and in its implementation, there is less emphasis on the contract complying with its provisions. Another issue is that questions regarding the products offered by BMT are designed to contain an element of dishonesty. In this case, it could be said that Sharia financial institutions also exemplify dishonest behaviour towards their members and the community. This is our common homework that the current Sharia financial ecosystem sometimes only emphasises the institutions, while there is less emphasis on society.

On the other hand, BMT financing staff also plays a role in selecting the appropriate contract for the proposed financing needs. In this case, financing staff need to understand financing contracts so that they can choose the right contract for financing proposed by members, the majority of whom do not have understanding or knowledge regarding Sharia financing contracts. In practice, the BMT determines the type of financing contract used, while members are usually not given the opportunity to negotiate regarding contracts that are appropriate to the proposed financing. This is as mentioned by participant (IBA4):

"Including those who choose the right contract for the customer in question or, conversely, the customer does not know the many contracts available so he cannot choose which alternative contract is more suitable given his limited information from BMT so he cannot negotiate whether to use the contract -another contract."

Thus, Sharia compliance efforts start from choosing the right contract as well as emphasising and aiding in implementing the contract in accordance with Sharia.

## **2) BMT Member Factors**

Several factors trigger agency problem that arise from BMT members.

### **a. Financing members' business conditions**

Most members who do not pay financing instalments are because the business goes bankrupt, the financing member migrates to another area (due to economic factors) or dies. Family conflicts and economic problems that occur unexpectedly in the middle of the financing journey can also have an impact on changes in the character of finance members. In certain trader community-based group financing, changes in market conditions such as the market not being as busy and sales being quiet will affect the process of returning financing obligations to BMT. This is as stated by participants (IBPF2 and IBPA3):

"... On average, our members don't pay because the first time their business sometimes goes bankrupt, that's the case, then the second time, many of them go and migrate to Malaysia, so some of them die. Well, sometimes we have problems with this, but there aren't many of them. The maximum remaining loan amount is 100 thousand, some are 50 thousand, that's what..."

"Well then, eee, the problems with these members are usually eee, the characters mentioned earlier are also influenced by other factors after running, for example, eee, at first there were no problems, that's good, yes, everything went well. And in the middle of the journey, there are family conflicts, for example. "Yes, usually economic problems or problems like that can become family conflicts and that has an impact on BMT."

### **b. Member's lack of morality**

Character is one of the main causes of agency problem. Bad characters include members' dishonest behaviour. Members deliberately stall, don't want to pay, or don't have the awareness to pay. In this case, sometimes there are bad intentions from

prospective financing members from the start and then there is a gap or opportunity to realise these intentions into real action. This is as stated by participant (IBPD1):

“The occurrence of dishonest behaviour is a crime. That's what Mr. Nafi said, there are two reasons: one is an intention, the second is an opportunity, right? Yes, sometimes there is no intention, but the opportunity is wide open, finally it happens, one of the opportunities that make employees dishonest and trustworthy is because they are holding money, the management of this centre should reduce, eeee, what is their opportunity, that is an opportunity, their opportunity is to do proud, so the system should be formed in such a way, not just based on your lecture model, don't steal you, if you are not equipped with a system, they will continue to commit theft. "But if the system has been created like that, then like it or not, they will be subject to the existing system, so they can't do that, you know, so as hard as someone can do it, you have to trust you, but if the system is open."

In some cases, members cover up information because it is not appropriate or there are deviations from Sharia in the implementation of the contract, which could mean that the member knows that this is not true. In conveying information related to real business results, for example, most members are still thinking about the profits and losses they will get so the income information submitted does not correspond to actual conditions. On the other hand, when applying for financing, members deliberately hide information because they have a need and want the funds submitted to be disbursed in full. In this case, when filling out the financing data submission form, some information is sometimes not filled in or filled in with invalid data.

The bad character of a member can sometimes be detected at the beginning of the financing process and there are also those that appear or only become visible after the financing is underway when the member has problems and is driven by the member's condition. On the other hand, in the difficult conditions experienced by members, there are opportunities and opportunities to carry out bad actions. Lifestyle also has an impact on how much a person spends. A person's high lifestyle can cause a person's expenses to be high and if it is not in line with existing income it can result in delays in obligations that must be fulfilled, such as financing instalments, for example. Members also sometimes act secretly from BMT, such as applying for financing to BMT and it turns out that behind the scenes, these members also carry out transactions with mobile banks where funds from BMT may not be used according to what is stated in the contract and

are used to pay debt obligations to the loan sharks. With so many dependents there is not enough capacity, or in other words, the ability to pay instalments is not in line with their income.

### **c. Low understanding of members regarding financing agreements**

Some of the member problems that can trigger agency problem are that there are still many members who do not know or understand the contract. On the other hand, education for members sometimes cannot be directly digested by members. This is as stated by participant (IBPF4):

"Well, rioters really need a process of understanding both mothers, both BMT perpetrators and unusers or members who are BMT partners. I often try to use the language slowly and not too high because all of their notes are what it is called, basically asking for funding from BMT is called a loan or debt. I'm trying to take it slow; this is the difference between debt and financing."

The majority of BMT members are unbankable people who in fact have low or even no education. On the other hand, when implementing the contract, members also do not pay attention to the explanation regarding the contract and therefore still assume that the financing transactions carried out are no different from loan transactions at conventional institutions. This shows that there is still a need for Sharia financial education for members and society in general. On the other hand, Sharia financial literacy can be said to be still low on both sides, both BMT HR and BMT members. BMT development for members and the community has not yet been carried out optimally in the sense of being carried out correctly and seriously. This is as stated by participant (IBA3):

"Oh, yes, that's very clear, and it seems like in the PBMT community there is the MKU [Building the First Family] movement, which is guidance for entering routine recitations and so on, yes, but it's the same as in the world in general education. If educational activities are carried out wholeheartedly then the results will also be good, but if they are carried out with small talk then the results will be small talk and that is not just a problem of education carried out by BMT, any education including that on campuses too if done haphazardly and only to meet the project requirements, that's how it is, the output is also different. "In the

coaching program with BMT, when it is done correctly, as far as I know, the impact is very positive."

During the financing process, members sometimes have concerns that the financing will not be approved if they convey true information or are psychologically depressed and afraid to reveal true information. Another case is that members do not pay attention to or ignore the explanation of the contract. Several issues related to Sharia financial literacy can trigger agency problem, especially in micro-business financing at BMT.

#### **d. Urgent need and concern**

In some cases, members deliberately do not convey real information because they need urgent funds and want their financing application to be approved and there is concern that the financing application will not be approved in whole or in part if they convey the information openly in accordance with actual conditions. On the other hand, BMT financing staff also sometimes do not conduct detailed surveys of prospective financing members. This condition creates opportunities for agency problem, especially for new members outside the market who need a more accurate financing analysis compared to traders in the market, many of whom are usually BMT members. This is as stated by participants IBPA4 and IBPB4:

"Yeah, there's something, the name of it can't be revealed. "If it's open, the concerns will automatically be disapproved."

"Because you're afraid of ACC, or say yes for capital, bro."

This explanation states that the behaviour of members who do not convey information correctly is caused by two things, namely an urgent need on the one hand and a fear or worry that their application will not be approved if they convey the information correctly.

A brief explanation regarding the factors affecting the occurrence of agency problem in micro-business financing at BMT can be seen in Table 5.9.

Table 5.9 Factors Affecting the Occurrence of Agency Problems

No	Factors	Evidence	Agency problem Occurred	
1	<b>BMT HR and Governance</b>	HR and Governance	Lacking Accuracy in Financing Analysis	Adverse Selection
		HR	Limited capacity and quantity of BMT HR	Ex-ante moral hazard Post-ante moral hazard
		Governance	Lack of BMT supervision	Ex-ante moral hazard Post-ante moral hazard Untrustworthy behaviour
		Governance	Poor BMT Governance	Untrustworthy behaviour
		Governance	Lack of Sharia compliance in implementing financing contracts	Adverse Selection Ex-ante moral hazard Post-ante moral hazard Untrustworthy behaviour
2.	<b>BMT Members</b>	Capacity	Financing members' business conditions	Post-ante moral hazard
		Moral and Education	Member's lack of morality	Adverse Selection Ex-ante moral hazard Post-ante moral hazard Untrustworthy behaviour
		Financial Literacy	Low understanding of members regarding financing agreements	Adverse Selection Ex-ante moral hazard Post-ante moral hazard
		Condition and Psychology	Urgent need and concern that the application will not be approved	Adverse Selection

Source: Main data (processed by the author)

Based on Table 5.9. The factors that influence agency problem can be classified into two, namely: 1) BMT HR and governance; and 2) BMT members factors which include capacity, morals, education, financial literacy, condition, and psychology of members. From the perspective of BMT members, psychological factors were found to be one of the factors affecting the occurrence of agency problem, namely adverse selection. This provides an illustration for future research that can be viewed from a psychological perspective regarding the existence of adverse selection in micro-business financing in BMT. In addition, based on qualitative evidence, lack of Sharia compliance in implementing financing contracts and Member's lack of morality are the two main factors triggering the occurrence of the four types of agency problem in micro-business financing at BMT.

## **5.12 BMT PROGRAM IN MINIMISING AGENCY PROBLEM**

Based on research data, the programs implemented by BMT to minimise agency problem include:

### **1) Improving BMT governance, including through:**

#### **a. Standardization of clear and measurable SOPs**

BMT which already has SOPs includes the staffing SOP at IMFIs<sup>4</sup> which, based on information from the IMFIs<sup>4</sup> manager, this SOP has been approved by the Manpower Service and is a reference for other cooperatives. IMFIs<sup>3</sup> also has a financing SOP which is used as a reference for financing officers in carrying out their duties in the field. Thus, the SOP already exists from the head office. As time goes by, it is possible that certain points will be added to the SOP. This is as stated by participant (IBPC2):

"Maybe I don't know the old one, but the possibility of just adding points, so it doesn't change at all, if in the past it was just an ID card and then adding a marriage certificate because maybe there was an incident before that turned out to be the wife, the wife was married or something, then you had to use a marriage certificate and better equipped administratively."

Financing SOPs also exist in BMT, for example, the obligation to guarantee both physical and social collateral. In its implementation, the SOP is still supervised by the manager who is also responsible for financing activities at the BMT. On the other hand, to optimise the implementation of duties, financing staff (Account Officers) assigned to members or prospective members are also limited to certain targets in terms of financing analysis that will be submitted.

### **b. Routine evaluation**

Routine evaluation at least every week, especially in financial matters. This is important to do because when BMT grows and has many branches, it needs regular and intense evaluation. If there is a quicker evaluation then things will be better, and the problem can be resolved as quickly as possible. On the other hand, if the evaluation of the problem is left for a long time, the problems will continue to increase and accumulate and will become difficult to resolve. This routine evaluation activity has been carried out by IMFIs<sup>5</sup> as stated by IBA1 which also provides input to BMT throughout Indonesia:

"I ask you to evaluate the performance, don't take too long. If we carry out an evaluation it is weekly. Because when there are financial problems, the branches have spread a lot, so the problem can't be left alone for a month, then it will be hit by another problem. So, the evaluation is faster, with evaluations per week it will be better, you know. So, the problem can be resolved as soon as possible. But if you leave the evaluation for a long time, the problems will continue to pile up and become more difficult to solve. "So that's management, management or governance."

### **c. Delegation of division of tasks**

In carrying out its activities, BMT, which already has several branches even in quite remote locations, implements a clear and good delegation of division of tasks between BMT administrators and managers within the scope of one BMT office and between the head office and branch offices. For example, this program is implemented by IMFIs which has a representative delegation at the branch office to represent the supervision of the head office to the branch office. Included in task delegation is a clear division of

tasks so that each BMT officer knows and understands his responsibilities. Such as marketing, account officers, and managers, each need to know their duties and responsibilities. This is as stated by participant (IBPD1):

"Yes... it's impossible for the representative management to have a branch in Bali, we have a branch in South Kalimantan, it's impossible to supervise this, that's why we appointed one representative for the management there, so that's the kyai, this kyai. So, this is one of our strategies. to handle supervisory management also for those who have cooperatives and those who have members, so when RAT Kita is the one who gives up on going there like I did to Kalimantan, it's impossible for my member participants to go to Kalimantan yesterday, right? That's not possible, member participants. "We came from Kalimantan to Pasuruan, right? Yes, we were the ones who went there and that's what we held so you understand. There was a member meeting and there were door prizes. There was also training, so there were several activities that we did."

## **2) Utilization of Information Technology**

System digitalization is important in a financial institution. This is because financial transactions require transparent data recording for every transaction carried out. In financing, BMT can monitor financing management by BMT financing officers through the system. With the digital system, BMT can monitor progress updates on the instalment movements of each financing member, whether smooth or problematic. This is as explained by IBA4:

"...Then the technological approach with digitalization means that BMT can monitor the update progress of the movement of instalments from each member, which is column 1, column 2, column 3 and so on, through an application to make it easier, including eliminating other than the monitoring side of analysis of existing instalments. "This is also to minimise management from the BMT officers themselves because the problem is not only from the members' side who may not or lack the ability to pay, but also from the officers' side, a system must be created to reduce the moral hazard of members who are not deposited at the office and so on..."

However, there are still BMTs that use manual systems in their activities. This condition usually occurs in BMT with limited segments where activities can still be carried out manually. On the other hand, application procurement and maintenance

costs are also separate considerations, especially for BMTs with small or limited market segments. For example, regarding system servers, some BMTs still consider how effectively the digital system is used in BMT. In practice, it is necessary to calculate what percentage of members use the system and how much it costs.

Most BMTs still use a rental system for the system servers they use. This is because the cost of procuring or purchasing a server is not small. This is as explained by participant (IBA2):

"... but I'm honest, I haven't explored how effective it is in suppressing Fraud. I don't know yet because what I see is precisely this. What I see first is how much it costs to publish the application, secondly how much money it costs to maintain it later, thirdly, how much cost is spent on renting a server? I'm sure they don't have their server; how come they're still renting? That's right [laughs] it's not cheap, you know, that server..."

On the other hand, those who usually use the system are in certain age groups, which incidentally are young people. Meanwhile, elderly members or officers usually cannot use the digital application system. In addition, with the manual system, BMT officers must come to members who can also make visits and maintain direct communication with members. Some examples of carrying out activities using a manual system are recording financing deposit transactions using payment cards with manual recording, recording in the field is written manually then the money is taken and counted and then the transaction data is entered in the office using Excel which can be edited at any time and sometimes there are often discrepancies and BMT officers must find the difference. For manual systems, usually each month it must be calculated again one by one and needs to be grouped again one by one. In this way, the system increases transparency, data is safe, and energy is not drained.

Compared to the manual system, in the past, when members wanted to deposit funds for savings, they still needed to record using a typewriter, then there were computers, and now we have developed a system that makes recording easier. In the early days, not all BMTs used the system because the costs were expensive and BMTs had to pay these costs. However, when compared, the benefits of this system are much greater.

Based on research data, there are several systems used by BMT which can be seen in Table 5.10.

Table 5.10 Information Systems used in BMT

No	System name	Description	BMT							
			IMFIs 1	IMFIs 2	IMFIs 3	IMFIs 4	IMFIs 5	IMFIs 6	IMFIs 7	IMFIs 8
1.	System server	A computer device used to serve requests from other computers (clients) on a network.	v	v	v	v	v	v*	v*	v
2.	Financial bookkeeping system	System for inputting BMT financial transaction data	v	v	v	v	v	v	v	v
3.	Central Financial System	A financial system that is centralised and connected to the financial system at the head office							v	
4.	Mobile AO / Mobile Marketing	One of the digital media used by BMT officers to input member transaction data in the field.			v		v	v	v	v
5.	Mobile BMT	An application intended for BMT members to be able to carry out transactions and check transactions online via mobile phone.	v	v	v	v	v	v	v	v
6.	mobile print out	Portable printer to print proof					v	v	v	v

No	System name	Description	BMT							
			IMFIs 1	IMFIs 2	IMFIs 3	IMFIs 4	IMFIs 5	IMFIs 6	IMFIs 7	IMFIs 8
		of member transactions in the field								

\* Already has its own server

Sources: Primary Data (processed by the author)

Table 5.10 describes the use of digital systems at each BMT, where all BMTs use a system server, financial bookkeeping system and BMT mobile application services. Not all BMTs use mobile AO/marketing applications and mobile printers. Interestingly, only one BMT uses a central financial system. For BMT that has developed, the central financial system is used to minimise the occurrence of fraud and optimise supervision. This system is suitable for BMT which already has many branches in locations that are not easy to reach. This is an interesting thing that needs to be investigated further, why BMT does not use a central financial system. Some of the benefits felt from having a digital system are:

- a. With mobile BMT, members can carry out and check transactions, both savings and financing, in real time.
- b. With mobile BMT, members are disciplined to be honest and trustworthy.
- c. With Mobile AO / Marketing BMT staff can input, check member transaction data in the field, and increase transaction transparency in the field.
- d. Portable printout to print proof of member transactions in the field, thereby giving members the opportunity to check whether their transactions are appropriate or not and increasing transparency of transactions in the field.
- e. By using the system, after inputting the report, there is no need for bookkeeping anymore.
- f. The digital system adds transparency, data is safe, and energy is not drained. Compared to a manual system

Apart from the benefits obtained by using the system, BMT sometimes still faces problems or obstacles in using the digital system, including not all members are aware of the existence of the BMT mobile application, some know but do not use it because they don't want to or feel they can't use it or because they still use old types of cellphones that cannot be used to access or install the application. The BMT mobile and AO / Marketing mobile applications can only be downloaded and installed by members on Android phones. On the other hand, not all members receive socialization of the BMT mobile application, sometimes only members who apply for a large financing limit are offered to install the BMT mobile application so they can access their financing history.

Online application server information sometimes experiences problems, or the server goes down. In these conditions, BMT officers must carry out manual recording if there are transactions. So, Funding Officer (FO) still carries withdrawal and deposit slips for manual recording in the field. If an error occurs, it will be easier to detect because the system will not be able to close if the balance sheet still does not balance assets and liabilities. In this case, BMT officers must first look for the location of the error until they find it and then the system can be closed. With this system, BMT staff are required to be more careful in inputting transaction data because if there is even the slightest transaction error, the balance will not balance, and the system cannot be closed. If the system has not been closed by the next day, all transactions will return to the previous day's transactions. If the system has not been closed, all related officers cannot go home that day because closing the system must be done at the BMT office. In this way, if there is an error in inputting transaction data, either by accident or by someone deliberately cheating, it will be known. In the case of checking transaction errors, the Internal Control System will also check transaction errors.

### **3) Emphasis on Sharia compliance in the implementation of financing contracts**

One of the BMT programs to minimise the occurrence of agency problem is to be careful and emphasise the implementation of contracts so that they are truly in accordance with Sharia principles. This program is implemented by IMFIs<sup>1</sup> which starts with selecting a contract that suits the members' needs, then there is an emphasis on the conformity of the contract with Sharia principles in the implementation process, starting

from the survey, signing the contract, and continuing with assistance during the allocation of financing funds. This is as explained by participant (IBPA1):

"If the survey isn't delivered at the time of the contract, we'll just say it again when the contract process is different, we'll call the AO. Why does this happen? There's a lack of emphasis. because he only admitted it when the contract was like that. OK, then for future evaluation lessons you must emphasise that. and must deliver. There are also cases where we are not allowed to buy cigarettes. It turned out that while he was shopping, he had already taken cigarettes, we paid for him. Well, it turns out there are around 1 million cigarettes. In the end, we issued a contract, so in the end we used bailout funds, as we say. if we don't enter into an agreement, he will give us back, for example, 200, 300 a month according to his ability. When I called, why did this happen? because he didn't convey to the members. "Our team didn't convey it to the members, I see."

IBPB1 also conveyed similar things, sometimes prospective financing members do not convey actual information regarding financing needs. In these conditions, the efforts made by IMFIs<sup>2</sup> are through emphasising the time of the contract where when confirmed again at the time of signing the contract, the member only conveys actual information regarding the proposed financing needs. This is as stated by participant (IBPB1):

"In practice, yes, ma'am, even though we are careful like that at the beginning, sometimes there are those who are like that, and we usually reinforce that in the contract, during the contract, sometimes the member says, "Yes, sister, I want to use this" like that, that's where we were like come on, ma'am, what's the point? There's still an admin fortress, right? If it's for those who agree with the admin, yes. The flies are spawned there, so there are several forts, huh..."

As an example of Sharia compliance in contract implementation, namely in a murabahah contract, BMT can carry out the contract by buying and selling goods which can then be transacted with members. In the murabahah bil wakalah contract, BMT can aid in the implementation of the contract up to the allocation of financing funds provided. This is as explained by participant (IBPA4):

"Well, that is by improving compliance with Sharia contracts following the Sharia Council, which we must follow in operations. God willing, if you follow the Sharia Council's fatwas and agreements. Because indeed, to be honest, maybe our friends at other BMTs who are still there today

gave us their money. The money that is distributed is open, the members spend the money. There are more members who shop like that because it's from the party's side. The members are really complicated, want this, want this. Even when there are old members, their business is good, they are a bit reluctant, why do I have to follow my shopping, we pay. That's quite a bit, maybe there's something like that, it's complicated or maybe there's a sense of embarrassment too, why would you buy the proceeds from a loan for financing like that, there are also those who object to that. But if we educate directly, then the contract scheme requires buying and selling, while buying and selling goods must be controlled by the BMT first and then discussed with the members. BMT does the shopping, then after shopping it sells to members. "Education like that, understanding of the Sharia, usury is a very serious sin, it's the same as adulterating one's own mother."

IBPA4 explains that one way of implementing contracts in accordance with Sharia is by referring to the DSN MUI fatwa, which has issued special fatwas related to contracts implemented in Sharia financial institutions in Indonesia. This is an issue because implementing contracts in accordance with Sharia teachings in practice is sometimes not easy to do, especially for BMT members, the majority of whom have low literacy in Sharia finance.

#### **4) Increasing Human Resources BMT Capacity**

Increasing HR BMT capacity is carried out online or offline, including through:

- a. Training to BMT HR with material on Sharia finance, bookkeeping, finance, training, and information system facilitation. Training on BMT is carried out by related institutions such as the Cooperative Service and PINBUK. However, this training is only carried out periodically, such as once a year, and not all BMTs can take part in the training. The training that is usually carried out is internal to each BMT, either with speakers from within the BMT or by bringing in speakers from outside. BMT internal training is carried out specifically for each division or employees, who usually study product introduction, product in-depth study, contract patterns, as well as other matters related to financing, as well as leadership. This is as stated by participant (IBPA1):

"We usually have training once a week for each activity. For example, Monday is for sub-district officers. Tuesday Head of Division. Wednesday for AO officers. So, on Thursday and Friday, we'll do it. This Saturday, it's just a complete taklim. "That's just why the officers have a long time."

To increase HR capacity, several BMTs also sent several of their employees outside the region to attend training.

- b. Spiritual touches in the form of study, reading certain letters of the Qur'an, Duha prayers, and praying for goodness for BMT members before carrying out BMT activities. For example, this activity is carried out by IMFIs with the name "Short Lecture" which is held once a week, namely on Saturdays and filled directly by the BMT chairman. This is as explained by participant (IBA1):

"We employees must have a spiritual touch every day, so as employees, we convey this in carrying out our mandate, our trust must be maintained properly in accordance with the vision and mission that we have set, namely trustworthiness, responsibility, dignity. If you abbreviate it, it's a solid term. So, if it is written in Arabic, it will be good for those who repent. So, from here, before each implementation, we require all employees to perform Dhuha prayers first, at least 4 raka'ahs."

At IMFIs1, the BMT HR development program is carried out with a specific curriculum which includes material on tahsin, aqidah, and economics or muamalah. Apart from that, for BMT employees, there is a target to complete reading 30 chapters of the Al-Qur'an in one month. The next agenda is a briefing activity related to evaluating errors or information that is not clear to BMT employees. At IMFIs8, BMT HR development activities are carried out through *ta'lim* activities every Friday evening and Tuesday morning for administrators and managers (BMT forum throughout some regions). At IMFIs3, coaching activities are carried out through morning prayer meetings at 07.00 before BMT activities.

A more detailed explanation regarding the HR capacity building program that has been carried out by BMT can be seen in Table 5.11.

Table 5.11. BMT HR Capacity Building Program

No.	Institution	Activity	Description of Activity	Category
1.	IMFIs1	Morning briefing before starting the activity.	Target each reading 30 juz which is then followed by a coaching and evaluation	briefing agenda
		Routine training and coaching for BMT management staff once a week.	Each section has a routine schedule every week using certain modules, namely Monday, Tuesday, Wednesday For Thursday and Friday, the activity is Tahsin Al-Qur'an. Saturdays are used for overall taklim activities for religious studies for spiritual enlightenment.	Training and coaching
2.	IMFIs2	Training invites external speakers.	For example, training invites accounting officials as training speakers	Training
3.	IMFIs3	Monthly recitation	Recitations conducted once a month for BMT administrators and managers, for example, carried out in Gunung Kidul	Coaching
		Morning briefing.	A briefing event every seven in the morning before starting BMT activities which contains morning prayers, reading the Koran, light evaluation, and plans for what agenda will be implemented that day.	Coaching
		Evaluation per section	Evaluation activities per section carried out at uncertain times, sometimes once a month	Evaluation of activities
4.	IMFIs4	Routine recitation every Friday morning before starting BMT activities.	Routine recitation activities are carried out once a week, namely on Friday mornings	Coaching
		Initial training for new employees	Training activities held for new employees for three days with material	Training

No.	Institution	Activity	Description of Activity	Category
			on Sharia ideology and BMT regulations	
5.	IMFIs5	Routine recitation every Saturday morning (KulKas - Short Lecture).	This activity is attended by BMT staff at the head office which is filled with recitation to enlighten the heart so that it is not affected by world affairs.	Coaching
		ISHOMA activities every day before starting work activities.	Activities carried out every day before starting work activities are filled with dhuha prayers in congregation followed by istighatsah to pray for yourself and your members.	Coaching
		Study the book of turats twice a month.	This activity is carried out to maintain the soul of each staff so that it is not empty and remains alive and their intentions remain organised by taking the lessons from the book.	Coaching
		Skill or insight improvement and update program.	This program is carried out so that BMT has adequate HR that can compete.	Training and upgrading HR capacity
		Training	Training in making financial reports for marketing for a week.	Training
		Training for employees once every quarter	Training for employees which is carried out once every quarter which includes HR, branch heads and branch offices in their own areas	Training
6.	IMFIs6	Sends staff to take part in training.	BMT sends some staff to take part in training outside BMT, such as in Yogyakarta.	Training
		Certification of expertise for each staff BMT	staff strives to have expertise certification such as expertise certification for AOs and managers.	Skills certification
7.	IMFIs7	Training from the cooperative department.	Several staff attended training held by the cooperative department	Training

No.	Institution	Activity	Description of Activity	Category
			with material usually about financial bookkeeping.	
		System training from PINBUK	Training attended by several BMT representative staff with system-related material and held by PINBUK Training	Training

Sources: Primary Data (processed by the author)

Based on Table 5.8., each BMT has held HR capacity building activities, namely in the form of training and coaching. However, each BMT has its own model for implementing the program. For training activities, several BMTs have their own initiation by holding training or sending several management staff to take part in training. This is as mentioned by participant (IBPH3):

"Sometimes, last year we actually carried out the training ourselves, Miss, the training ourselves, Miss. So, we are part of the PMT BMT, we brought in the trainers, we brought them ourselves, but what kind of knowledge do we get if we just rely on the journey as it is? "That's why yesterday, in 2022, after Corona 2021, it seems like just last year we had the chance to meet for 3 days at the self-help hotel and BMT friends, we all did it, we invited the material so that we could increase our core knowledge, that's why the managers and administrators are all the people we invited."

Meanwhile, other BMTs only take part in training activities if there is an invitation for training held by the cooperative service or related BMT organizations such as PINBUK for example. Based on these data, the awareness of each BMT in carrying out HR improvement programs for each BMT is different. There are BMTs that have high awareness of increasing HR capacity and there are also BMTs that implement these programs if there is a program from the government or other related institutions. On the other hand, in some training, sometimes not all staff can take part in the training. Especially for training outside BMT, only a few selected staff can take part in the agenda.

For coaching activities, the majority of BMTs have coaching programs for either their administrators or management staff. The intensity of training or coaching activities

at each BMT also varies. For training, there are BMTs who have a regular training schedule, even if it is only one month, three months, or once a year. On the other hand, there are BMTs who do not have a regular schedule for training activities. For coaching activities, the majority of BMTs have carried out coaching activities. However, the intensity of the coaching varies. There are BMTs that have a regular schedule for coaching activities, while other BMTs do not have intensive activities in terms of coaching. Some of the obstacles faced by BMT in implementing training and coaching include funding constraints and the pandemic conditions that hit during 2020–2022, resulting in several training and coaching activities not running.

##### **5) Training, coaching and mentoring members.**

One of the member coaching and mentoring activities is carried out through visits by BMT officers to members. On average, BMT makes daily visits to its members which are usually carried out by marketing officers or funding officers. However, there are also BMTs that do not make daily visits to their members due to the limited HR owned by the BMT and the long distance from one member to another, so the BMT also utilises digital communication via messages via WhatsApp or direct contact via cellphone. During these daily visits, officers usually provide savings and/or instalment pick-up and drop-off services as well as providing members with an understanding of the contracts and financing mechanisms. This coaching activity is sometimes hampered by the limited time for BMT officers to visit each member and the large number of financing members who must be visited on that day.

Marketing officers or FOs usually visit members at their place of business in the market, market area, outside the market, or at their homes. This daily visit is also carried out by financing officers who are usually called Account officers and financing managers regularly, one of which is to maintain good communication intensively.

Guidance is also carried out indirectly through the socialization of verses and hadiths related to Sharia-compliant transactions, such as verses and hadiths about lending and borrowing which are included in savings books, financing application

forms, financing instalment cards, and wall decorations in the form of calligraphy of verses or hadiths at the BMT office.

However, there are still BMTs that never provide training for members at all. In this case, the relationship between BMT and members can be said to be only in terms of transactions. Some of these members are only invited to the Member Meeting which is held once a year and usually what is conveyed is related to BMT developments and problems with speakers from the BMT management and the Cooperative Service. This condition was found in BMT located in the eastern region of Indonesia where education on understanding Sharia finance was carried out minimally. One of them is through lectures by BMT administrators who insert several teachings related to Sharia finance to the community. This was conveyed by IBPG3 when asked whether there was a member development program or not.

"But BMT has never done it here, there is only RAT every year."

Apart from coaching activities, training for members is also carried out by several BMTs in Indonesia. For example, MSME training by IMFIs collaborates with BAZNAS by bringing in trainers from Surabaya and members are also given business capital. The training material provided is related to bookkeeping, marketing methods both offline and online, and promotional methods. Regarding bookkeeping, members are taught bookkeeping in the form of how to set aside balances, debits, credits, expenses, and income. In this training, there is also a member consultation session so that members can increase their financial recording skills.

IMFIs 4 has its model in terms of training, coaching and mentoring members, the program is named "member school" which, based on information from the manager of one of IMFIs's branch offices and the chairman and founder of IMFIs, this program can be said to be an icon that differentiates IMFIs from BMT. other. Until the end of 2022, this program has run 11 rounds with around 900-1000 members participating from the province where IMFIs is located. In this program, BMT will convey the programs available at BMT to members. On the other hand, members can also convey problems and obstacles from each business and then discuss how to solve them. In this way, two-way communication is possible from both BMT parties and members.

Technically, this program is fully funded by IMFIs by inviting 80-100 members to a certain location and then providing members with school education in the hope that ownership motivation for IMFIs will emerge among members. Furthermore, IMFIs raises the level of education by facilitating the marketing of member products online either using the existing marketplace, namely the basket or creating member groups. Furthermore, IMFIs raised the education level to business matching where BMT brings together members with different but related businesses to be able to mutually subsidise and meet. Apart from the coaching program, IMFIs also provides member business assistance in the form of assistance in making NIBs, halal certification, how businesses can be sustainable, one of which is by creating content, and then how to market members' business products. This is as explained by participant (IBPE3):

"Firstly, we have a program, thank God, it is already running, it is called a member school, we have been doing this for member schools for a year, we convey this in relation to the programs at IMFIs<sup>4</sup>, what are the programs we convey, and it is also a place for member schools to vent. For example, if there is a problem that the business is not good, then the business declines, and then related to our marketing in the field it is not good, we say, Thank God, this has been going on for a year. Secondly, we provide assistance to members, Alhamdulillah, currently our team is making halal certificate certificates, so at BIF, we provide assistance to members for making NIBs, the second is making halal certificates, the third is how to sustain business that creates content, which "What about this content so that the business is sustainable, then we also participate in marketing, now this is the assistance that we provide, so what, so that people who use BIF financing feel accompanied..."

Moral development activities are also required for BMT members where there is notification about the contract mechanism, for example at IMFIs<sup>9</sup> there is a regular monthly recitation every 15th for members who are given the name *Limolasan*. This activity is intended so that members understand the mechanisms of Sharia financial instruments so that they will not commit fraud. Another activity is also carried out when there is a financing problem, namely by praying together with the member and it turns out that the next day the member pays the financing instalments. Coaching activities at other BMTs are also combined with social activities in the form of donations which are then followed by coaching activities for members in the form of recitations. During the COVID 19 pandemic where there were activity restrictions, there was a change in the coaching model by conducting online studies for both members and non-members. For

example, this study was held by one of the BMT associations, namely ABSINDO, which was called the Tuesday Night Study (KAMENSE). This is as explained by participant (IBA2):

"We have organised this program again, right? In 2022, in 2023, we will start to organise it again so that for the forums we will revive it practically starting in 2021-2020, there will already be a program. But in March or February, when the pandemic was declared, all the movements limited, like it or not, many of our programs won't work, we even have to cut or cut our business targets like that, because market conditions don't allow it, right? In 2021 it's a bit cooler, right, even though it's still very limited, so in 2022, right? "It's already starting to loosen up when in 2021 we put together a program in 2022, it's not a little loose but it's not loose, in 2023 we'll put together another program, like forums, and then we'll hold it again offline..."

Guidance for both BMT HR and members needs to be carried out not only once or twice, but it needs to be ongoing and accompanied by evaluation activities and then further developed until it is finished.

At IMFIs<sup>1</sup>, before the COVID-19 pandemic, there were outreach activities to members. This activity was carried out by inviting several members to take part in training with material related to business management and family financial management. BMT has not explained the explanation regarding products that are not permitted. The obstacle faced by BMT in holding training is time constraints, most members are traders who are busy trading every day, so it is difficult to determine the appropriate time. If you are going to hold the training, BMT also needs to prepare the costs given to the training participant members, such as transport money as compensation because the member does not sell on the day or time of the training. Another alternative that can be done is coaching members through officers who visit members. However, the limited number, time, and energy of BMT HR in visiting such many members is another obstacle in terms of providing guidance to members. On the other hand, BMT also needs to provide briefings to each officer on daily visits to members, especially in terms of understanding BMT products so that when there is an opportunity to provide guidance to members, they can deliver it well and optimally. Another opportunity to provide understanding to members is during the contract where BMT can provide detailed explanations as well as provide education to members.

At IMFIs6, assistance to members is first carried out by the AO and then through education to members which is held twice a month (since 2015). In the member education activity, a maximum of 25 members, both members and prospective members, were gathered to be given material about BMT, financing, Sharia transactions, and social activities such as how to donate and give waqf through BMT. In this forum, BMT can also help market member products. By providing intensive understanding, it is hoped that closeness will be built between members, and they will be able to remind each other of good things. This is as explained by participant (IBPF2):

"... mentoring for members is firstly from marketing or what is known as AO, then secondly there is member education, which is twice a month, we are trying it once a year. So, as time goes by, we try 2 times a month. "So, the assistance there explains how to apply for BMT, the financing process is like that, right, and everything goes there regarding how to donate, how to make waqf, all kinds of things, let's go through BMT..."

An indication of the success of the program is members' awareness of giving infaq and contributing to social activities because the training also conveys how to give infaq, do good deeds, and be oriented not only to the world but also to society and the hereafter. For activities once a year, there is a Member Meeting where members with certain criteria are invited, such as being diligent in saving, diligent in principal savings, and diligent in financing. Apart from that, IMFIs6 also offers the Umrah and Blessing programs for planning Umrah for members, which is an effort to improve members' spiritual side.

At IMFIs8, there is the formation of market groups by BMT according to the type of business where each group also has recitation activities. However, as time went by one by one the group members left and eventually the group disbanded.

At IMFIs, assistance to members is through AO by providing direction to members. AO assistance is carried out through daily visits to members and directing members to allocate their income to savings. So that at the maturity date, financing instalment payments can be taken from these savings. The AO's role is very important in aiding BMT members to help management fulfil their business obligations. This is because, in the realm of microfinance, people sometimes don't understand business management. This assistance can also help synergise raw material needs between

members. So that one member can synergise and collaborate with other members. For recitation programs, there is no obligation for members to take part in the program. The training program for members is carried out once a year along with a member meeting that travels to all BMT branch areas. The training material is usually related to improving entrepreneurial skills according to the needs of each BMT regional branch.

IMFIs2 utilises existing recitations in the member's business market. BMT joined in and took part in the market study activities. However, from the COVID 19 pandemic until now these activities have stopped and have not started again. There was also training that did not have a fixed time once a year regarding financial recording and business development. Guidance to members through marketing officers is usually only in the form of communication providing suggestions, however institutional guidance from BMT does not yet exist. Mentoring to members can be carried out to simultaneously increase literacy among members through casual chats with members while inserting the values of increasing literacy. Islamic finance there. In this condition, special communication skills are required from BMT officers to be able to establish emotional relationships with members so that members can easily understand Sharia finance. The training, coaching and member mentoring programs can be seen in Table 5.12.

Table 5.12 BMT Program for Its Members

No	Institution	Special Program for Members	Training	Coaching	Mentoring
1.	IMFIs1	Program for members	v	v	v
2.	IMFIs3	-			
3.	IMFIs2	Developing members by joining market associations		v	
4.	IMFIs	Member Schools	v	v	v
5.	IMFIs	Roadshow program between regions per year	v	v	v
6.	IMFIs6	Program for members held twice a month	v	v	v
7.	IMFIs7	-			
8.	IMFIs8	-			

Sources: Primary Data (processed by the author)

Each BMT provides direct guidance and assistance to members through field officers, namely marketing or AO, with the intensity of each BMT varying according to the time and conditions of the BMT officers. In addition, some BMTs have special programs intended for members. Four BMTs have special programs for members which include training, coaching, and mentoring for members. One BMT has a special coaching program for members by joining the market association agenda of members' business locations. Three BMTs do not have special programs for training, coaching and mentoring members. Several obstacles were found in implementing the program for members, namely 1) it was difficult for micro-business actors to find time to take part in training or coaching activities due to busy events and the absence of employees to replace them when they wanted to take part in BMT activities; 2) BMT's lack of funds to provide training, coaching and mentoring activities for members; 3) low awareness of members to participate in BMT activities; 4) COVID-19 pandemic conditions where there are restrictions on activities in all sectors in Indonesia.

### **5.13 STRATEGY TO MINIMISE AGENCY PROBLEM**

To minimise agency problem at BMT, several strategies carried out by BMT include improving BMT governance and increasing HR capacity and Sharia financial literacy among BMT HR, BMT members and the community.

#### **1) Improved Good Corporate Governance**

One effort to minimise agency problem at BMT as a financial institution in the form of a Sharia cooperative at the micro level is through improving governance. This is as explained by participant (IA3):

“So actually, the problem is that BMT is actually syar’I, it’s actually a level context, yes, the easiest level to change that can be done is at the micro level, namely changing governance, changing incentives, right there. “How about BMT, what is the term the mall is the same as the tamwil road, we have to prepare a good management system.”

The participant (IBPA3) also conveyed something in line when explaining BMT's efforts to deal with agency problem, namely by strengthening the governance system:

“Maintaining the sustainability of the BMT institution in facing agency challenges is one, strengthening the governance system,

#### **a. Clear regulations**

Improving BMT governance requires clear regulations, especially in terms of supervision from relevant policy stakeholders, namely the Ministry of Cooperatives and SMEs and the Financial Services Authority (OJK). Regarding the direction of institutional regulations, it is still an issue for BMT. There need to be clear regulations on whether BMT is under the authority of financial services or the cooperative department. There are several differences of opinion regarding this matter. One party said that BMT should be under the supervision of the OJK so that the supervision system can be further improved. The majority of BMT still hold their opinion and choose to be under the supervision of the cooperative ministry because it is seen as closest to and in accordance with BMT's identity. Another party said that there was a need for a business entity model that was more suitable for BMTs other than the PT and cooperative forms.

#### **b. Clear Standard Operational Procedures**

One effort to improve governance is to have clear SOPs for each BMT, especially SOPs relating to financing activities. This, as explained by informant IBPF2, is one of BMT's efforts to minimise agency problem, namely:

"... then the third is that the rules must be clear. The SOP must be clear..."

This SOP can serve as guidance for financing officers in carrying out their duties in the field. Among the SOPs for BMT financing, for example, is the obligation to provide collateral, both in the form of physical and social collateral. However, each

BMT usually has a different SOP and there are some SOPs that are not written. As explained by the informant (IBPF4) who stated:

"Yes, so in our experience there are standards that must be used as a reference, for example, this financing standard,"

"Yes, there are also a lot of SOPs that are not written, yes, the written SOPs are general in nature, if the ones that are not written, these SOPs are born from experience, right? That's how experience is, oh we are wrong here, we are not strict here, that's why we set up BMT on a whim. Oh, the results are also mixed at the same time, the risks are also mixed."

The explanation regarding SOPs for BMT above states that there is a need for special SOPs for BMT, which is important in managing BMT. Apart from that, the implementation of this SOP also needs to be monitored so that it is carried out optimally. Therefore, in managing BMT, you need to be serious because you will be faced with big risks related to the rights and obligations of both the BMT and other related parties.

One of the SOPs that BMT needs to have is the SOP for carrying out the duties and obligations of BMT management staff. In carrying out its activities, it is also necessary to have a clear and good delegation of the division of tasks between BMT administrators and managers within the scope of one BMT office and between the head office and branch offices. BMT can also have a representative delegation at the branch office who can represent the supervision of the head office to the branch office. Included in task delegation is a clear division of tasks so that each BMT officer knows and understands his responsibilities. Such as marketing, account officers, and managers, each of them needs to know their duties and responsibilities.

### **c. Clear and accurate financing analysis**

Financing analysis is an important thing that needs to be carried out by BMT to minimise agency problem. BMT needs to improve the accuracy of financing analysis by being more thorough and more detailed in carrying out financing analysis to prospective financing members. Several things that need to be considered in the BMT

financing analysis are related to business conditions, collateral and the BMT information system.

Prospective members' business conditions include project certainty with indicators of timely payment and appropriate reports, project risk level, financing period, and business health. There is a guarantee for the project, project prospects, and project return rate. The collateral value must cover 100% of the financing funds. For nominal financing above IDR 3,000,000, there must be collateral. For financing under IDR 3,000,000, members can get it without collateral which will be provided for the old member who has been regularly saving at BMT for at least three months. If this is not fulfilled then a personal guarantee is required from the BMT financing officer, in other words, the financing is based on the recommendation of the BMT financing officer. Accounting information systems are a separate issue regarding what and how information systems are for micro-businesses. Regarding this issue, in practice, at least there is information from members regarding the results obtained and business conditions as a monthly report to BMT.

#### **d. Surveillance System Optimization**

Improvements in BMT governance include optimising the supervision system and standardising SOPs at BMT. BMT needs to carry out supervision and coaching on an ongoing basis so that it can continue to exist and develop. One way of optimising supervision can be carried out by conducting regular evaluations at least once a week on the performance of BMT financing. For BMT, which already has many branches with locations that sometimes take time to reach, it is necessary to have representative administrators at least in each BMT branch area. Related to this; in selecting representative management, representatives can be selected from community leaders who are already known to the local community in the area. This strategy can be called a 'community-based verification strategy' where in carrying out verification to members, BMT involves prominent parties in the community. In this way, the BMT management already knows and is recognised by the community so it is predicted that there will be trust in each party, namely between the community members and the BMT and vice versa. Furthermore, this strategy can be used to handle supervisory

management at BMT. One of these strategies is implemented by IMFIs<sup>5</sup>, which already has many branches spread across several provinces in Indonesia. An explanation regarding this matter was provided. This strategy can be used to handle BMT supervisory management. This was as stated by participant IBPD1:

"Yes... it's impossible for the representative management to have a branch in Bali, we have a branch in South Kalimantan, it's impossible to supervise this, that's why we appointed one representative for the management there, so that's the *kyai* (cleric), this *kyai*. So, this is one of our strategies. to handle supervisory management also for those who have cooperatives and those who have members, so when our RAT is the one who gives up on going there like I did to Kalimantan, it's impossible for my member participants to go to Kalimantan yesterday, right? That's not possible, member participants. "We came from Kalimantan to Pasuruan, right? Yes, we were the ones who went there and that's what we held so you understand. There was a member meeting and there were door prizes. There was also training, so there were several activities that we did."

Supervision of BMT cannot be separated from government support and regulations where the majority of BMT are under the supervision of the cooperative ministry. There is a need to improve the supervision of BMT as a Sharia cooperative, which is still an issue, especially for BMT. This is as explained by participant IBPD2:

"The recent issue is related to supervision of cooperatives. Maybe at the centre will be the draft that will be the draft. But from this cooperative development forum, don't let what is called this cooperative move without our supervision. Because our nature is almost different from banks, the family relationships and values in cooperatives may not be in accordance with the principles of cooperatives. That's a hot issue lately. It's only been changed this week."

"What if supervision remained at the cooperative ministry? So, it's hard for us to build the cooperative metric given to the OJK, right? It would be better for us to improve supervision at the Ministry of Cooperatives itself. "Make it partially accommodated by the person concerned."

Based on the explanation above, it is stated that monitoring BMT is an important thing that needs to be done by policy makers. Currently, the majority of BMT feel that it is more appropriate to be under the supervision of the cooperative ministry. This reality occurs because the values implemented in BMT are closer to cooperatives, for example, the family relationships implemented by BMT are the same as the principles

in cooperatives. Therefore, what needs to be done is to improve the existing supervision system at the Ministry of Cooperatives and SMEs for BMT which is part of cooperatives, namely Sharia cooperatives. On the other hand, if the supervision of BMT is under the OJK, it is feared that it will direct the implementation of BMT activities towards financial institutions such as banks which optimise the values inherent in BMT such as prioritising the principle of kinship. It will be questioned whether this can be implemented or vice versa.

#### **e. Utilization of Technology and Digitalization of Systems**

Even though many BMTs have utilised technological systems, optimising the use of these systems still needs to be done. For example, related to agency problem, one of the obstacles for BMT in selecting prospective financing members is the absence of a financing data detection system in microfinance institutions. In terms of selecting prospective financing members, there needs to be a support system that can detect loan or financing data at microfinance institutions, which currently does not exist. A system like this already exists in banking, namely in the form of BI checking which can provide information regarding the loan or financing track record of prospective customers. Therefore, BMT usually relies more on direct financing analysis for prospective members. However, in some cases, the financing analysis data is difficult to obtain, and ultimately adverse selection occurs in BMT. This is as explained by participant (IBPG2):

"In my opinion, in these institutions, there is a system that can detect, when the data is entered, there is a name, like the current banking system. It's like the current banking system, if there's a problem, the name will appear there, so it's known, right? "This is something that doesn't exist yet, it's all manual, so maybe in the future if there is something like that on a small scale in that area, with the system it can detect it."

Based on the explanation above, it is stated that currently there is no system for detecting financing data in microfinance institutions, which can trigger the wrong choice of financing members which has an impact on financing problems in the future.

The eight BMTs that are the object of research already use support systems in their operational activities such as the BMT financial recording system, mobile banking, mobile AO, and mobile printers. However, not all BMTs use all these systems completely. The difference in adoption or use of technology occurs on the one hand because there is no socialization regarding the new system or on the other hand there is a lack or absence of awareness on the part of BMT to update and upgrade the system they use. Interestingly, cases like this are not only found in BMTs in the eastern part of Indonesia where it is thought there is still minimal socialization regarding the development of BMT technology, but also in BMTs in Java. BMT also uses a mobile BMT system which involves members as users. This is a challenge for BMT where most users are small traders who are sometimes not technologically literate. Not only internally at the institution, to effectively digitise the system at BMT, there needs to be an outreach to BMT members to utilise the existing system so that members can feel the benefits, such as being able to carry out transactions and check transactions in real time without having to meet with BMT staff or come in person. to the BMT office.

The BMT digital system can also monitor progress updates on the instalment movements of each financing member, whether smooth or problematic. With a digital system, BMT can also monitor financing management by BMT financing officers. However, the system must continue to be updated according to needs. For BMT, which has developed as an example, the central financial system is used by IMFIs to minimise the occurrence of fraud and optimise supervision. This system is suitable for use by BMT which already has many branches in locations that are not easy to reach. The AO mobile and BMT mobile applications are used so that BMT and BMT members can check transactions, both savings and financing, in real time. At the same time, this also trains members' discipline to be honest and trustworthy.

#### **f. Sharia compliance**

Optimal implementation of Sharia compliance through emphasis and assistance in implementing contracts in accordance with Sharia needs to be done to minimise the occurrence of agency problem. In mudarabah contracts, for example, there needs to be a clear project and correct financial reports, which for micro-businesses, is the most

difficult challenge. Responding to this problem, as an alternative, micro-business actors do not need to make detailed financial reports, but the reporting can be in the form of an official report for recording monthly income. Normatively, when a financial institution carries out religious teachings correctly, it will be safe. The Qur'an An-nisa: 29 commands believers to conduct right transactions in accordance with Islamic principles and ethical rules, as detailed in the Qur'an and other Islamic teachings, as directed by Allah. Another example is in a wakalah contract, BMT needs to ensure that the goods being spent on are real goods that the financing member needs. This is because the murabahah contract is a sale and purchase contract where one of the conditions is that there is a buyer and seller and the object of the goods being traded. Thus, if there are no goods to be traded then the murabahah contract cannot be implemented. To minimise the occurrence of moral hazard, BMT can use contracts that have guaranteed results, such as murabahah and multiservice ijarah.

#### **g. Strengthening Maintenance Financing**

Maintenance of financing at BMT can be strengthened, including through regular visits by BMT staff to members and tightening supervisory management. With visits, BMT can have an early warning where BMT knows when a member has a problem so that it will be easier for BMT to fix it. For example, there are complaints from members when asked: "Why are sales down, sir?" and members answered, "Yes, sales are down because it's quiet." So, at that time, the officer can provide alternative assistance, and suggestions, for example, "Yes sir, we have a buyer who is a fellow BMT member." In this way, BMT officers can bring together members' businesses and of course, can also help the running of businesses between members. In the case of BMT, this is very possible to happen because BMT usually knows and understands the community of each of its members.

On the other hand, BMT HR also need to have financial management skills so they can understand the mechanisms and problems related to financial management in financing. In terms of supervision, BMT can tighten supervisory management where in practice, certain level managers cross-check members by random sampling regarding the validity of financing information reported by BMT officers. In this way, BMT can

find out whether the financing implementation conditions are in accordance with the SOP or vice versa. This supervision can be carried out on a community basis where the BMT manager is a Figure who is familiar known and trusted by the community where the BMT members are. In profit sharing-based financing agreements, businesses run by members must be visited regularly so they can monitor monthly income reports at least every month. This visit can also be used as an early warning for members whose progress has begun to decline or is not good. Officers can communicate regarding members' business conditions during the visit using light language such as: "How are you, sir? Is the instalment safe? And the results of the visit are stated in the officer's visit report to the members which will be reported to BMT.

Seeing the large number of activities carried out by BMT managers, it is necessary to have a certain standard ratio for the number of financing officers compared to the number of financing members. For example, in IMFIs it is implemented that each AO has a standard of at least having to have a financing member with a maximum transaction of IDR 250,000,000, -, if there are transactions above that then they must appoint additional employees. Thus, the number of employees in each office may be different according to the scope of the transaction. There is one office that is sufficient for five employees, while another office may require nine to 15 employees because the scope of the transaction is different.

## **2) Increasing Human Resources Capacity and Sharia Financial Literacy among Human Resources BMT, BMT Members and the Community**

### **a. Approach to members**

Strengthening BMT's internal HR is very important to mitigate agency problem in micro-business financing at BMT, one of which is through strengthening HR skills both on the spiritual and intellectual side, starting from HR recruitment to developing existing HR capacity on an ongoing basis. One recruitment strategy to minimise agency problem is to recruit HR who are known to the local community. This was explained by IBPD4, that the recruitment strategy can be based on the verse where Allah sent a Messenger *min anfusihim* or from the community itself.

"In that market, usually that's what has been done and done, if the maintenance is almost the same it's possible, only if BMT is more personal, otherwise there might be rewards, there are merchandise like that, if we take a more personal approach."

Apart from that, on the spiritual side, it is necessary to strengthen the mentality of BMT HR in dealing with members and the community who do not all understand or believe in BMT. On the other hand, the large number of members with limited time and energy requires skills in each field as well as an understanding of the spiritual values related to the activities of each field. Coaching, mentoring, and training are needed not only for BMT members but also for BMT's internal HR. Furthermore, HR skills also need to be continuously updated and upgraded according to BMT's needs. Increasing the competency of BMT HR in terms of approaches to members is also needed. BMT HR needs to have the skills to take a personal approach to members so they can build emotional relationships with members. The formation of BMT HR also needs to be carried out from HR recruitment where there are certain standards for prospective BMT HR.

Because BMT is a community-based institution, one of the criteria for improving HR is recruiting BMT HR from the local community which will make it easier for BMT to approach the community because the HR already know or are recognised by the local community. BMT can also collaborate with public figures or local community leaders by involving them as administrators or managers of BMT. Having Figures who are trusted by the community can make it easier for BMT to be accepted and trusted by the local community, especially for expansion areas or new branches of the BMT.

#### **b. Increasing BMT Human Resources Capacity**

One of the characteristics of BMT is its approach to members with a personal and family approach. In addition, the financing selection process for BMT can be carried out on a community basis. BMT takes a personal approach to members so that BMT has good relationships and can get to know potential financing members better. As is the Javanese

philosophy, when people know them well, they will hesitate to deceive those they know.

This is as explained by IBPB4:

"So, if it's a development problem, especially savings, you have to recruit from human resources who are known to be trustworthy. When recruiting, I take this from the verse why Allah sent an Apostle, that is, apostle *min anfasikum*, I study that verse. Yesterday, during my master's degree in the thematic al-Quran hadith course, I was given an assignment by the lecturer to write an article, so that's what I made. So, the impact of HR recruitment on the development of BMT is among the verses quoted."

On the other hand, in selecting prospective financing members, it is better if the prospective member is someone who can be accepted by the market or has a name in the community so that the person can seize opportunities. Apart from that, this person also has business skills and usually can manage business risks, then people who come from business families will usually be more knowledgeable and committed to business activities. Another approach that can be taken by BMT is an organising system approach through a group approach accompanied by social preparation in the form of mandatory group training with certain regulations. One example of this implementation is carried out by PINBUK at BMT KUBE and Micro Waqf Bank. The group approach at these two institutions is carried out by providing training that group members must attend five consecutive days with a duration of one hour per day. The special rules that apply are that each person cannot be late and if someone is not present for one day, then the group is considered disbanded. After each group passes the exam and the financing is running, there is a weekly *halaqah* to oversee the financing process so that it runs smoothly.

Friendship visits to members also need to be carried out by BMT, especially for problem financing members. The doctrine is never to get bored in reminding and visiting members until the members themselves get bored. Assistance to members through daily visits as well as a pick-up service for members' savings and instalment funds. Even members with good character also need guidance regarding their daily fund allocation. If there is no direction from the officer, the income funds obtained may be used for other things, but with daily visits and direction, the officer can direct members to allocate their income to daily savings which at the maturity date will be partially or completely funded. These funds can be used to pay financing instalments.

BMT can also provide prizes for financing members with a good track record. This program can motivate members to improve their financing instalment performance. BMT needs to build emotions with members intensively and sustainably. BMT can also utilise social funds to empower underprivileged people. This model was applied at IMFIs8, where the community had many overseas people and was a trial area. Someone could fail and come and migrate to this area, open a business again, then take out a loan, then fail, and run away again. In such conditions, IMFIs8 takes opportunities by utilising social fund to empower these people. Especially for problematic financing members, there needs to be continuous and intensive communication supported by coaching for these members. Matters related to financing must be conveyed openly and nothing should be hidden either to members or prospective financing members. So, there will be transparency of information for members and prospective members even before the financing agreement is implemented.

### **c. Increasing Sharia Financial Literacy among Members and Community**

How to increase public understanding regarding Islamic finance is a challenge for BMT, most of whose members are small traders who have low education and not all of them can even read and write. On the other hand, members' activities as traders are usually busy with daily transaction activities which require more effort to be able to spend time attending study or training forums, especially for members who do not have employees in their business activities. This is as explained by IBPG1:

"Not at', but Insya Allah, in the future, because he's a busy person too, he's in a shop, in the morning, he feeds a lot of people, because mealtimes are from morning until duhur, under (office location or event venue) that's 2 o'clock, if it's under 2 o'clock, the event is from 9 o'clock until duhur, so there's no time here."

This statement was immediately confirmed by one of the BMT members during observation activities (IBAG1):

"Yeah, I didn't have time, because I happened to be alone,"

However, efforts are needed from BMT with a special program to understand Sharia finance both to members and the community at large. BMT can do this both in official programs in the form of recitations or training for members and can also be combined with member assistance activities through daily visits which are usually carried out by FO, AO, and financing managers. By carefully planning a program that is being socialised, members can arrange a time to participate in the activity. The preaching of Sharia economics to members and the community must not stop and can be done by utilising various existing media and opportunities such as through social media, platforms, websites, and groups using video, text, status and others. This is because many members and society at large are not or are not yet familiar with Sharia finance. BMT can also collaborate with universities and religious and community leaders, policy makers and other related parties in the context of socialising and increasing public understanding regarding Sharia finance. This congregational da'wah needs to be done to help each other in upholding the truth as stated in Al-Ashr: 3:

إِلَّا الَّذِينَ آمَنُوا وَعَمِلُوا الصَّالِحَاتِ وَتَوَاصَوْا بِالْحَقِّ وَتَوَاصَوْا بِالصَّبْرِ

“Except those who have faith, do good, and urge each other to the truth, and urge each other to perseverance.”

### **3) Synergy and Cooperation with Related Institutions**

To optimise the role and function of BMT as an institution with dual functions, namely commercial and social, there needs to be synergy and cooperation between BMT and other related institutions. One of the ways this can be done is through optimising collaboration with related agencies to develop MSMEs and BMT. One of the obstacles for BMT in carrying out coaching for members is the lack of funds to carry out these activities. Therefore, support from the government is needed, one of which is in terms of funding coaching activities.

Each BMT also needs to have initiatives to be able to synergise and collaborate with potential institutions such as the creative economy ministry and other NGOs in

terms of improving entrepreneurial skills in accordance with Sharia teachings. BMT can also collaborate with BMT associations such as Indonesian Cooperative Forum (FORKOPI), Indonesian BMT Association (ABSINDO, PBMT), Sharia Cooperative Center (INKOPSYAH, PUSKOPSYAH, GAKOPSYAH), and other related institutions in terms of coaching and training for both BMT HR and BMT members. The tasks of the BMT association include three, namely education, facilitation, and advocacy. This is as explained by participant (IBA1):

“So, there is education. That's why it is necessary to increase insight into Sharia, for those who follow Sharia. Then carry out professional standardization, regardless of what profession it is. This is where education and facilitation are needed. What are the facilities? Maybe facilitate how a joint platform is formed to increase capacity. So, what, later it can be facilitated to take part in training. To follow this and so on. There is an advocacy function, let's just take this as an example, so advocacy is generally called BMT, right? It's vulnerable to contact with loan sharks, sometimes with people who don't like it, sometimes with people who are disappointed, sometimes you must face the law yourself. So, this needs to be built together. If yes, there is potential in that area, for example, here is a major for graduates with a law degree. When we finance them together, we assign them to carry out advocacy if there are members who face legal problems. So, so that this problem can be cleared, you are not alone in facing the problem. There's no one to help, right? So, this is where togetherness is needed. I think that's how it will be, and we have a lot of things to work on.”

In a statement regarding the three tasks of the BMT association, IBA1 said that there is a need for cooperation between parties to implement the association's tasks both in terms of education and facilitation for BMT members and the community, especially those related to Sharia finance and resolving legal problems for BMT, BMT members, and Society in general. In summary, BMT strategy in minimising agency problem and how its implementation needs to be in synergy and collaboration with other related institutions can be seen in Table 5.13.

Table 5.13 BMT Strategy to Minimise Agency Problem

No	Category	Program	Implications	BMT	BMT Association or Related	Regulatory Institutions	Synergy and Collaboration with Related Institutions
1.	Governance	Improved BMT Governance	Clear regulations	v	v	v	v
			There is a clear SOP	v	v	v	v
			Accurate financing analysis	v			
			Sharia compliance	v	v	v	v
			Utilization of Technology and Digitalization of Systems	v	v	v	v
			Surveillance System Optimization	v	v		v
			Strengthening maintenance financing	v			
2.	Increasing HR Capacity and Sharia Financial Literacy Increasing HR	Capacity and Sharia Financial Literacy among BMT HR, BMT Members and the Community	Approach to members	v			
			Increasing the Sharia financial capacity and literacy of BMT HR	v	v	v	v
			Training, coaching and mentoring members	v	v	v	v
			Increased public understanding	v	v	v	v

Sources: Primary Data (processed by the author)

Table 5.13. shows that most implications of all BMT programs (82% of the total program) require synergy and collaboration with other related institutions. This data shows the importance of synergy and collaboration carried out by BMT to maximise the impact of each of these programs.

## 5.14 CONCLUSION

Based on the research results, agency problem in microenterprise financing of BMT includes adverse selection, incompatibility of fund allocation, moral hazards, and untrustworthy behaviour. Adverse selection occurs when information is not conveyed during the selection process, leading to incorrect information being conveyed, submitted, or members using fake financing requirements files. Incompatibility of fund allocation also occurs, as financing members misuse funds without disclosing it to BMT. This can occur in qardhul hasan contracts, and murabahah bil wakalah contracts. Moral hazards at BMT include dishonesty in reporting business results and the escape of financing members. These issues can occur in profit sharing-based contracts, such as mudarabah and musharakah, and can occur in all types of contracts. Addressing this agency problem is crucial for effective microenterprise financing of BMT. The research suggests several solutions to minimise agency problem in micro-financial institutions (BMT). These include clear regulations, Sharia compliance, and financing analysis. Establishing regulations, encouraging micro-entrepreneurs to create suitable business entity models, and emphasising Sharia compliance is essential for implementing contracts in accordance with Islamic teachings. Financing analysis should be thorough and detailed, considering factors like project certainty, risk level, financing period, and business soundness. A guarantee for the project, project prospects, and rate of return is necessary, and collateral value must cover 100% of the financing funds. Implementing accounting information systems and a personal and family approach to members are essential, while a community-based approach is preferred for successful financing selection. By focusing on these aspects, BMT can better serve its members and ensure the smooth functioning of its financial institutions.

## **CHAPTER SIX**

### **DISCUSSION**

#### **6.1 INTRODUCTION**

This chapter focuses on the analysis and discourse of the study findings reported in the preceding chapter, specifically chapter 6. The research results were analysed utilising a contextual method based on the Islamic perspective. The organization of the analysis of the interpretation of results follows thematic patterns, consistent with the investigation of research findings mentioned.

#### **6.2 EXISTENCE OF AGENCY PROBLEM IN MICROENTERPRISE FINANCING OF BMT**

Agency theory is an organizational relationship between principals and agents. The concept of agency, namely agency theory, can be seen as a version of game theory which creates a contractual model between two or more parties, where one party acts as an agent and the other party is called the principal. Agency theory is a theory that explains the relationship between owners and management. Agency theory states that if there is a separation between the owner as the principal and the manager as the agent who runs the company, agency problem will arise because each party, both the principal and the manager, will always try to maximise their utility function. Based on research data, agency problem in BMT include four cases, namely Adverse Selection, Ex-ante Moral Hazard, Post-ante Moral Hazard, and Untrustworthy Behaviour in BMT HR. This reality is in line with what was conveyed by Scott (as cited in Dadbeh & Mogharebi, 2013) who stated that information asymmetry is divided into two types, namely adverse selection, and moral hazard. According to Guruganesh, Schneider, & Wang (2021), the classical principal-agent problem occurs when an agent takes actions on behalf of the principal, influenced by moral hazards and adverse selection which can lead to inappropriate actions or biased decisions, such as contract decisions.

In practice, BMT offers several micro-business financing contracts, namely murabahah, mudarabah, musharakah, ijarah, and qardhul hasan. Each of these contracts has different risks of agency problem. For example, based on survey results, the musharakah contract is the most unpopular contract for both BMT and BMT members. This is because of the high level of difficulty and potential agency problem with the contract. Adverse selection occurs because of asymmetric information which then has an impact on ex-ante and post-ante moral hazard. This condition can occur in new and old financing members who have applied for financing many times and may have loan or financing obligations outside BMT.

As one of the IMFIs in Indonesia, the implementation of the contracts used in BMT provides evidence in Rahman's (2010) explanation that several contracts have the potential to be adopted by Sharia microfinance institutions, namely Mudarabah, musharakah, murabahah, ijarah, and qardhul hasan. According to Rahman (2010), Sharia financial schemes are moral and ethical in nature and are successful in encouraging micro entrepreneurs towards success. These schemes can be adapted and improved from microfinance objectives, using risk mitigation strategies to increase their effectiveness. On the other hand, the type of contract used in IMFIs is different from the reality in Islamic banking as explained by El-Gamal (1997) that the use of PLS contracts in Islamic banking is traditionally still limited due to the inherent risks, such as business failure, adverse selection, and moral hazard. Nevertheless, the findings of this study strengthen the argument that microfinance is a risky and crucial factor for its success because it can turn expensive ventures into profitable entities due to asymmetry, adverse selection, and moral hazard, thus making them economically and commercially viable (Hassan, Rahman, Bakar, Mohd, & Muhammad, 2013).

Regarding agency contracts seen from an Islamic perspective, agency arrangements are common in various modes of Islamic financing, including murabahah, salam, istisna, ijarah, and diminishing musharakah (Shah, 2022). The role of agents is very important in this financing method. In Murabahah, customers request goods from Islamic banks, which are usually appointed as agents to purchase goods on behalf of the bank. In salam, istisna, and ijarah, the customer sells the goods to the bank, and the bank appoints the same customer as the seller to sell the same goods on behalf of the bank. However, the excessive use of agents in this financing method raises concerns regarding

Sharia compatibility. Islamic banking offers significant advantages in corporate finance by enabling optimal risk allocation through the sharing of project profits between capital owners and entrepreneurs. However, these companies also face major problems between principals and agents due to asymmetric information and expensive monitoring.

The first case of agency problem is adverse selection which occurs when internal parties of the company, namely managers and the people involved in it, know more information than investors who are external parties to the company. This raises concerns that information that can influence shareholder decisions will not be conveyed optimally. Another case is the occurrence of moral hazard when activities carried out by internal company parties are not fully known by shareholders, investors, and creditors so that internal company parties can take actions outside the knowledge of shareholders, investors, and creditors.

In detail, adverse selection in BMT is a form of agency problem in micro-business financing, where prospective members are not informed about their actual needs or whether they are dependents. This problem can occur during initial communication with marketing staff who interact directly with members or prospective members. Members may not provide accurate information about income and other dependent data, which may affect instalments. Other issues occurred during the financing survey where members had taken out loans or financing at other financial institutions, potentially impacting their ability to repay those funds. New members may disclose information openly after experiencing problems with repayment of financing, such as failure to complete or traffic jams. The next survey carried out by the BMT account officer is important to collect further information in the context of analysing BMT financing. Falsifying the requirements for applying for financing is another form of agency problem in microenterprise financing. New members may intentionally falsify the requirements for applying for financing, thereby causing adverse selection. Adverse Selection is also prone to occur in unsecured financing provided by BMT for financing small nominal amounts with a ceiling of IDR 1,000,000. BMT usually analyses the place and length of business to compare it with market locations visited by BMT staff. However, some prospective members may not convey information that is not in accordance with existing reality. In conclusion, adverse selection is a significant

problem in microenterprise financing, especially in communities that do not have access to banking. It is very important to ensure accurate financing analysis before providing financing funds to prospective members to avoid potential problems and ensure smooth business operations.

The case of Adverse Selection in BMT as has been explained, if seen from the behaviour of its members, has two possibilities, namely carried out intentionally for a specific purpose or carried out accidentally due to prospective members' ignorance regarding the financing agreement that will be submitted. If done intentionally then this behaviour is not in accordance with Islamic teachings, namely conveying information correctly and on target. First, Allah commands us (Qur'an surah Al Baqarah, 2:42) to convey correct information that other people need to know and not to mix true news with fake news (Agustin, 2018). Submission of correct information by members is important for BMT because this will be a source of data for BMT to make decisions regarding financing proposed by prospective members. The second thing is related to the purpose of doing something. Prospective members have certain goals which are the reason why they deliberately do not convey correct information. In Islam, all activities depend on the initial purpose of carrying out the activity as stated in the hadith:

"From Alqamah bin Waqqash Al Laitsi, he said: I once heard Umar bin Al Khattab r.a. while he was on the pulpit, he said: I heard the Messenger of Allah s.a.w. said: "In fact, all deeds depend on intention, and that for each person it is what he intended. Strictly speaking, whoever emigrates because of the worldly things he wants to gain, or because of the woman he wants to marry, then his emigration will also be considered based on the intention with which he emigrated to her."

The hadith states that if one wants to start a practice or do something, one should set good intentions so that the practice or work is successful and gets a reward. If the intention is not good, then the results will not be good, and it is not impossible that it will lead to sin, if the practice is not accompanied by any intention, then it is a shame that it will not bring anything. present. The problem of adverse selection among participants will ultimately pose potential risks to the institution (Manan & Shafiai, 2015). BMT's ability as a faith-based microfinance to mitigate adverse selection problems and thereby encourage higher repayment is questionable (Khan & Phillips, 2010).

The financing case involved coverage of the allocation of financing funds by financing members who did not disclose this information to BMT. For example, this problem can occur in qardhul hasan contracts, where BMT does not know whether the financing funds are used for business activities. This is also a common problem in murabahah bil wakalah contracts, where BMT gives authority to financing members to spend on their business needs, even with assistance from BMT to minimise deviations. Members use funds in whole or in part for other purposes that are not in accordance with the terms of the contract. In practice, members also sometimes manipulate receipts for purchasing goods given to BMT. This behaviour includes cases of conveying incorrect information after a financing agreement has been made, which can fall into the category of violating the contractual agreement that has been made. So, two cases occurred, namely conveying incorrect information, and violating the contractual agreement. Both behaviours are not in accordance with what Allah SWT commands. The first is conveying information correctly (Qur'an Surah Al Baqarah, 2:42) even though it may be difficult to do (Qur'an Surah Al An'am, 6:152) and the second is a breach of contract, someone who violated the commands of Allah SWT. For people who believe in the (Qur'an Surah Al Maidah, 5:1) to fulfil "al 'uqud" or fulfil obligations. Ibn `Abbas, Mujahid and others in Ibn Kathir's commentary say that `obligation' here means agreement. Ibnu Jarir also said that what was meant was an agreement, like the agreements they usually make. `Ali bin Abi Talhah narrated that Ibn `Abbas commented, O you who believe! Fulfill (your) obligations. Therefore, believers are commanded not to damage or violate the agreement.

Moral hazard in BMT can occur when members report business results that are not in accordance with actual conditions, which can have an impact on mortgage instalment obligations. This case is usually called post-ante moral hazard, namely bad behaviour by members that occurs after financing funds have been given and allocated by members. Moral hazards like this can occur in mudarabah financing. Many members manipulate financial reports to minimise the profit-sharing ratio, thereby leading to manipulation of the agreement ratio. This can also happen when a member's business experiences a loss, causing the condition to be manipulated as if there was no loss.

The agency problem is also prone to occur in unsecured financing, where members with bad character can take the financing funds after disbursement. Members

with a bad character often avoid BMT officers, divert the conversation, or do not openly convey real information. Members with good character can be trusted and are loyal in paying instalments. In conclusion, moral hazard in BMT can occur when members report business results that are not in accordance with actual conditions, manipulate financial reports, or have bad character. In Islam, the untrustworthy behaviour that occurs in cooperation activities is discussed in the Al-Qur'an Shad (38:24) which states that most of the people who join are detrimental to each other except for those who believe and do good deeds. pious, and very few. Based on this verse, actions that harm other people are included in matters of faith and charity. Collaboration is an activity carried out jointly by two or more parties in carrying out work based on an agreement. Because cooperation is related to the rights and obligations of other people, commitment is required from each party to fulfil the cooperation agreement. However, in practice, not everyone is able to maintain this commitment, so a high level of commitment is needed to maintain each other's trust. In Islam, only people who believe and do good deeds can do this, this is not easy to achieve (Qur'an Shad (38:24)). BMT needs to address these issues and ensure the integrity of its financing system. This case highlights the importance of understanding the rights of the poor and the need for proper education on how to use funds responsibly. Members should be aware of the potential risks associated with using funds for other purposes, such as paying debts or for school purposes. BMT needs to educate its members regarding the proper use of funds and ensure that they comply with contractual provisions to avoid potential problems.

The research also revealed several examples of untrustworthy behaviour among BMT employees in Indonesia. Among them are employees who collaborate with members in financing matters, such as submitting requests for IDR 2,000,000 on behalf of members, saving BMT funds in their personal names, and accepting offers from financial institutions to save funds at their institutions with attractive promotions and bonuses. This can result in the embezzlement of member funds and the provision of bonuses for member funds deposited with certain institutions which are the rights of the fund owner. Another case was that BMT financing staff conspired with members to provide financing funds that did not comply with existing procedures. For example, a finance department employee, whom his mother trusted as a manager, took 50 million in the names of many customers, leaving 50 million trapped in the system. This issue is especially problematic when dealing with friends outside the organization.

In profit-sharing based financing, BMT employees cover information about members' business losses so that their superiors do not get angry. In murabahah financing, the marketing officer or BMT bears the cost of the price of the financing object. Other cases include embezzlement of financing savings or savings from BMT members, manipulation of member financing instalment data, taking over member funds by cooperative administrators, or BMT employees providing bailout funds for financing payments without providing confirmation to BMT. The term agency problem in financial institutions refers to the practice of covering up customer losses to avoid being scolded by superiors. Some board members did not take instalments correctly and did not take much, giving rise to civil disputes and potential financial discrepancies.

Several cases that have been described illustrate that cases of conveying incorrect information do not only occur with prospective members or BMT members but also occur with BMT staff. This behaviour is a matter of lack of confidence in BMT staff in carrying out their duties. As a Sharia microfinance institution, Islamic values are very important to be internalised in every BMT activity. To carry out this, high commitment is required, especially from BMT HR, to carry out their mandate as well as possible. In Islam, the concept of trust (Amanah) is something that God entrusts to humans (Triuwono, 2004). The expression of trust (Amanah) shows the individual's awareness of his role as caliph of Allah and of the people who are entrusted to him by Allah. Consequently, they must play their role according to God's rules (or norms). This is different from the idea that the meaning of trust which, to a certain extent, places greater emphasis on obtaining profits for the benefit of shareholders, in other words, it seems self-interested (Smith, 1853), self-centred (Ba-Yunus, 1991) and egoistic (Triuwono, 2004).

The existence of agency problem in micro-business financing at BMT shows that the thinking paradigm as stated in agency theory is still valid. In the ideal realm, as a financial institution based on Islamic teachings, this is not in accordance with what should happen. However, in the practical and empirical realm, this might happen. This fact has been mentioned in the Qur'an (QS Shad (38): 24) that most people are involved in committing injustice against other people. In the context of agency theory, an agency problem can be included as an example of unfair action. In this verse, Allah SWT. It is also stated that there are exceptions to this happening, namely except for people who

have two criteria, namely people who believe and do good deeds. At the end of the verse of Allah SWT continues to explain that the number of people who meet these two criteria is very small. This verse explains that most people who form associations, generally both Muslims and non-Muslims, will carry out the same actions.

In the context of agency theory in financial institutions, this indicates that agency problem can occur in financial institutions in general. The criteria for faith and good deeds applied to financial institutions are that they are truly committed to maintaining and carrying out all their activities in accordance with the principles and teachings of Islam as a whole, which is still a problem for Sharia financial institutions. In this case, Islam has already emphasised the importance of relationships, as emphasised in the Quran in Ali Imran (3: 173) which highlights the importance of building a concrete relationship with Allah, which is crucial for good relationships with other humans and living things. This principle is present in Islamic economics, where relationships can exist between various entities such as capital providers, entrepreneurs, buyers and sellers, agents and principals, contributors and beneficiaries, pledgees, and asset owners. The discussion on the principal-agent relationship in Islamic economics began during the Prophet's era but occurred later when Islamic economics emerged as a new field. Researchers have explored the link between capital structure and Islamic bank performance, Islamic law origin and finance, Islamic business contracts, and the need to harmonise Islamic banking and finance to consolidate Sharia principles in operations. However, the principal-agent relationship in the Islamic economic field does not expand much due to being clouded by conventional views or empirical works testing various disciplines in economics and finance (Shamsuddin & Ismail, 2013).

### **6.3 HUMAN RESOURCES AND GOVERNANCE AS MAIN DRIVER FACTORS OF AGENCY PROBLEM**

Based on the research results, two factors have an impact on the occurrence of agency problem, namely factors from the BMT institution and its staff and factors originating from BMT members. Factors originating from the BMT institution include BMT HR and BMT governance. The factors that originate from BMT members include business capacity and conditions, morals, education, financial literacy, and psychology.

Regarding BMT HR, explains that the first IMFI aims to help microeconomic actors inject religious and human values to avoid practices prohibited by Islamic law, such as usury, gambling, and uncertainty. With this main goal, qualified HR are needed for BMT, which is a critical factor in the growth of BMT, so that it can achieve one of these noble visions. However, Suherman and Suyandi's (2023) findings states that in the field of Sharia cooperatives, HR is one of the weaknesses due to the scarcity of qualified HR and the main problem in the development of BMT in Indonesia (Rusydiana & Devi, 2021).

HR at BMT is tasked with preparing ordinary people to fully understand the Islamic financial system, as they should provide a detailed explanation of the Islamic financial system to ensure a comprehensive understanding of Islamic finance. According to Pudjihardjo and Noor (2021), HR are an internal factor that influences the sustainability of BMT in Malang Raya, East Java Indonesia. Apart from improving accounting management, it is necessary to improve HR in an effort to overcome financing constraints at BMT (Dariah, 2012). These efforts include conducting comparative studies and training, managing monthly meetings to evaluate performance, and planning development programs based on comparative studies' results for financing and savings. The lack of clear provisions and official oversight in BMT institutions leads to agency problem, poor performance, and potential industry negative trends, potentially causing the bankruptcy of BMT (Kristianto, Ratnawati, & Riyadi, n.d.). This is in accordance with Satar and Kassim's (2020) assertion that BMT faces challenges in growing human resource capability due to limited business scope and capacity, budget constraints, and poor performance. This leads to operational failure and bankruptcy for many BMTs. Agency problem arises when authority is delegated, or a specific duty is assigned to a party against another (Anisykurlillah, Fachrurrozie, & Mukhibad, 2016). The theory of agency suggests that the owner, or principle, gives authority to managers to organise a company due to the complexity of its operations. However, agency problem arises when the obtained information often differs from the principle reported by the agent. The agent, acting as the company's manager, has extensive information about the company's performance and future progress, but is hesitant to provide all this information in line with the principle.

The first case is related to the selection process, agency problem in BMT is mainly caused by inaccurate financing analysis. Although providing BMT financing seems very easy, financing cannot be given indiscriminately. There is a procedure that must be carried out by a financing agency to provide such a statement. In terms of financing analysis, BMT uses the analysis principles commonly used by banks, namely those that BMT often applies using the 5 C principles and Sharia compliance. This is as explained by Thalib, Hajati, Kurniawan, and Aldiansyah (2020) that BMT financing requires a systematic process, using the 5C analysis in banking, a manifestation of the principle of prudence. This assessment prevents customer default and ensures the right person receives the financing, allowing them to exercise their rights as a BMT customer. This 5C analysis also helps implement Sharia compliance in BMT's business activities. BMT still faces agency issues due to varying commitments among staff and BMTs to implementing principles in financing analysis activities. This results in agency problem in micro-business financing because many members are unbankable and have low capacity and ability to pay. Apart from that, members' business conditions can also cause problems such as a sudden decrease in income, market decline, and sudden business bankruptcy. BMT's leniency in financing analysis may make it more trustworthy, but it can also increase convenience if there are many financing problems.

On the other hand, the mastery of financing analysis among BMT officers is questionable, as some officers lack the appropriate field of expertise and have low education. This results in insufficient information mining and the absence of a loan or financing data detection system. In addition, a lack of communication skills among members also affects their willingness to convey information in detail. The system for collateral obligations at BMT is also loose, creating opportunities for misuse of funds and embezzlement of collateral. The main problem in providing financing is identifying financing members with good character and trustworthiness, as information about their character and business capacity may not be clear. Members may also apply for loans from loan sharks or have dependents, triggering ex-ante and post-ante moral hazard.

BMT HR faces challenges due to its limited capacity and quantity of HR, leading to agency problem. The HR team is often insufficient to serve financing members and has multiple tasks, such as surveys, financing analysis, visits, and instalment pick-up. As BMT grows, communication between BMT and members

becomes less smooth, affecting emotional closeness. The quality of BMT HR is not always high, as some financing officers focus on collectability rather than the quality of transactions, leading to a lack of professionalism and trustworthiness. Misunderstandings between internal BMT employees can also occur, and the large number of matters and limited capacity of BMT, especially those handling financing, hinder the accuracy of financing analysis. Poor communication between BMT officers and funding candidates can lead to agency problem in financial institutions, including improper instalments and civil disputes over financial register accuracy.

The BMT faces numerous challenges, including poor management, lack of standardization of procedures, and inconsistent SOPs. Poor management, such as poor auditing and inadequate risk management, is due to a lack of focus on community-based practices and a lack of understanding of community needs. Inconsistent SOPs in BMTs can lead to ineffective implementation and inefficiency in the development process. Time frames for implementing procedures are often not met, causing insufficient support. Supervisors need to understand financial bookkeeping to carry out their duties correctly and provide immediate corrections if errors occur. There are gaps in routine and detailed supervision, as those without knowledge are often asked to supervise. To address these issues, BMTs should focus on community-based practices, standardise procedures, and ensure proper management and support from stakeholders.

The implementation of financing contracts should adhere to Islamic Sharia principles to avoid agency problem. BMT provides funds directly to members without considering the contract type and lacks ongoing assistance in implementing contracts. This can lead to inappropriate contract selection and weak emphasis on contracts during surveys and the process of implementing financing contracts. In such conditions, the murabahah bil wakalah contract has less emphasis on contract compliance. Additionally, questions regarding BMT's products often contain dishonesty, exemplifying dishonest behaviour towards members and the community.

Agency problem in BMT also stem from member factors like business conditions, Sharia financing understanding, dishonest behaviour, lifestyle, and lack of education. These factors can lead to haphazard implementation of contracts, poor results, and a lack of Sharia financial literacy. BMT financing staff play a crucial role

in selecting the appropriate contract for proposed financing needs, but members often lack knowledge or understanding of Sharia contracts. members' dishonest behaviours, such as deliberately stalling, refusing to pay, or hiding information, can also contribute to agency problem. Lifestyle also plays a role in a member's spending habits, leading to high expenses and delays in obligations. Additionally, members often avoid providing actual information about their financing applications due to urgent needs and concerns about approval. This can create opportunities for agency problem, especially for new members who require more accurate financing analysis. By following the Sharia Council's fatwas and agreements, BMT can improve compliance with Sharia contracts and avoid agency problem.

#### **6.4 INEQUALITY AND LACK IMPLEMENTATION OF BMT PROGRAMS**

To minimise agency problem, BMT has several programs, including improving governance through standardising clear and measurable Standard Operating Procedures (SOPs) for financing activities. These SOPs, such as IMFIs personnel SOPs and IMFIs<sup>3</sup> financing SOPs, are used by other cooperatives and financing officers in the field. As time goes by, certain points may be added to the SOPs, such as the obligation to provide collateral. The implementation of these SOPs is supervised by the manager responsible for financing activities at BMT. BMT also conducts routine evaluations at least every week, especially in financial matters, to address problems that cannot be ignored for up to a month. This helps resolve problems quickly and prevents the accumulation of problems. IMFIs conducts these evaluations weekly, as branches spread quickly, making it easier to address financial issues.

BMT also implements a clear delegation of tasks between administrators and managers within the scope of one BMT office and between the head office and branch offices. Each ensures that each BMT officer knows their responsibilities, including marketing, account officers, and managers. This strategy also helps handle supervisory management for cooperatives and members, ensuring smooth operations and efficient management. Increasing BMT HR capacity involves various online and offline activities, including training for employees in Sharia financial material, bookkeeping, finance, information system training, and facilitation. Training is conducted by related

institutions like the Cooperative Service and PINBUK, but it is only conducted periodically, such as once a year. Internal training is carried out for each division or employee, studying product introduction, contract patterns, financing, and leadership.

The spiritual touch is provided through study, reading Quranic letters, praying Dhuha, and maintaining trust for BMT members. IMFIs conducts a "Short Lecture" every Saturday, where employees must perform Dhuha prayers before implementation. An HR capacity building program has been held by each BMT, with each having its own model for implementing the program. Training activities are held by several BMTs, with some holding their initiatives or sending management staff to participate. Coaching activities are carried out by the majority of BMTs, with varying intensity.

Other obstacles faced by BMTs in implementing training and coaching include funding constraints and the pandemic conditions from 2020-2022, which resulted in some activities not running. To increase BMT HR capacity, BMTs should focus on enhancing their core knowledge and ensuring that their employees have the necessary skills and resources to effectively carry out their mandate. BMT officers provide member coaching and mentoring through daily visits, offering services like savings and instalment pick-up and drop-off, understanding contracts, and financing mechanisms. They also provide guidance through the socialisation of verses and hadiths related to Sharia-compliant transactions. However, some BMTs do not provide training, leading to a relationship primarily focused on transactions. Members are invited to annual meetings to stay informed about BMT developments and problems.

Several BMTs in Indonesia offer training, such as MSME training by IMFIs and BAZNAS. IMFIs has its model, the "member school," which at the end of 2022, has run 11 rounds with around 900-1000 members in the Special Region of Yogyakarta. IMFIs plans to revive the program in 2022 and 2023, with plans to start in 2021-2020. Before the COVID-19 pandemic, IMFIs<sup>1</sup> conducted outreach activities for members, but time and energy constraints limited these activities. IMFIs aided through daily visits and directing members to allocate their income to savings for financing instalment payments. Some of these BMTs have special programs aimed at increasing members' Islamic financial literacy. However, not all BMTs have special programs for members that require specific cost allocations and not all BMTs have sufficient funds for these

purposes. Apart from that, there needs to be a high level of commitment for BMT to continuously provide coaching, mentoring and education to members which also requires allocation of energy and time. From the member's side, activities as a micro entrepreneur that take up time and energy throughout the day are another problem in being able to take part in BMT programs. although there are some members who still try to find time and energy to attend the BMT activities. In Islam, someone who still takes the time to study during his busy life has a special position. This is as stated in the hadith that seeking knowledge is a good thing:

“Said Humaid bin Abdul Rahman, I once heard Mu'awiyah who was standing making a speech, he said I once heard the Prophet s.a.w. said: Whoever Allah desires good for himself, He will surely give him understanding in religious matters. And I am Qasim, that is, I like to share (what Allah has given me), and Allah is the one who gives. And this people will continue to stand by Allah's command, without caring about who opposes it, until Allah's command comes.” (Saheeh Bukhari, Book of Knowledge, hadith 72).

One of the things that can be learned from the hadith above is that activities related to increasing knowledge were always encouraged by the Prophet s.a.w. and the person who tries to increase knowledge is the person chosen by Allah to be given all goodness (Semait, 2006).

Digitalization is crucial in financial institutions for transparent data recording and monitoring of transactions. In financing, BMT can monitor financing management by using a digital system to monitor the instalment movements of each member. This minimises management from BMT officers and reduces moral hazard for members who may not be able to pay. However, some BMTs still use manual systems, especially in limited market segments. The cost of application procurement and maintenance is a separate consideration, especially for BMTs with small or limited market segments. Manual systems are mainly used by young people, while digital applications are not suitable for elderly members or officers. Manual systems also require BMT officers to visit members and maintain direct communication. In contrast, digital systems increase transparency, data safety, and energy efficiency. In the past, manual systems were used for depositing funds for savings, but now they are more accessible and efficient.

Although not all BMTs initially used digital systems due to high costs, the benefits of digitalization are much greater.

IMFIs uses a central financial system to minimise fraud and optimise supervision, despite having many branches in difficult-to-reach locations. The benefits of a digital system include real-time transactions, disciplined honesty, increased transaction transparency, portable printouts, and no need for bookkeeping. However, BMT faces challenges such as not all members are aware of the BMT mobile application, and not all members receive socialization. The mobile application is only available for Android phones, and not all members receive the application for large financing limits. Online application server information can sometimes experience problems or server downtime, requiring manual recording. BMT officers must be more careful in inputting transaction data, as even the slightest error can cause the system to close. Closing the system at the BMT office is necessary to prevent errors and ensure the safety of the system. Internal control system (SPI) will also check transaction errors.

The BMT program ensures Sharia compliance in financing contracts, starting by selecting a contract that suits members' needs and ensuring conformity with Sharia principles throughout the process. This includes surveying, signing, and assistance during fund allocation. Examples of Sharia compliance include Murabahah contracts and Murabahah bil wakalah contracts. Some BMTs emphasise following the Sharia Council's fatwas and agreements to prevent usury and ensure compliance with Sharia principles. Unfortunately, not all BMTs have a strong commitment to maintaining every activity, especially in terms of implementing contracts, so that they are truly in accordance with Islamic principles. This is because, in practice, some contracts are difficult to implement for financing members, so they require a strong commitment to Sharia compliance. From the members' side, the low level of Sharia financial literacy is a challenge to be able to direct Sharia compliance in terms of contract implementation. In this case, several BMTs experience a transition period where when the BMT is committed to Sharia compliance in implementing the contract, members will leave the BMT and move to another financial institution that provides easier services. This occurs due to the low understanding of both the BMT and BMT members, especially regarding the implementation of contracts in accordance with Sharia.

In conclusion, BMT has a system for standardising clear and measurable Standard Operating Procedures (SOPs), but there is no uniform SOP for each BMT. Some BMTs use nationally standardised SOPs, while others use old ones from other institutions or institutions such as PINBUK. Routine evaluations are not conducted by all BMTs, and Sharia compliance is not emphasised in financing contract implementation. Six technology systems are used by BMTs, with three being used by all BMTs and three by a few. One BMT uses all six systems. BMT capacity building and Islamic financial literacy activities include coaching programs for staff, training programs for members, and special programs for members. However, three BMTs do not have special programs for training, coaching, and mentoring. These programs aim to minimise agency problem and ensure smooth operations. Based on this explanation, BMT already has programs to minimise the occurrence of agency problem. However, each BMT has a program that is different from one another. Apart from that, the implementation of these programs also varies, where there are BMTs that have implemented the program optimally so that the benefits are felt with minimal or no cases of agency problem. On the other hand, there are still BMTs that have not implemented the program optimally or do not even have a program priority in minimising agency problem. The main reasons for the imbalance in the existence and implementation of the BMT program are that there are still obstacles to implementing the program, lack of management, and the lack of quantity and quality of qualified BMT HR, especially in BMT in the eastern part of Indonesia.

## **6.5 NEED FOR SYNERGY AND COLLABORATION TO MAXIMISE BMT PROGRAM IMPLEMENTATION**

Based on the analysis of aggressive strategies conducted by Amalia (2022), BMT is a community-based agency that has an opportunity to capture the market. Building upon the preceding discourse, specifically regarding the factors contributing to agency problem in micro-business financing at BMT. This matter is found to be interconnected with other entities, specifically BMT, BMT members, government policy, and society at large. Given this circumstance, BMT faces significant challenges in reducing the possibility of agency issues. Amalia (2022) highlights the constraints of BMT in relation to financial resources, personnel, and promotional tactics. To address

these challenges, it is imperative to enhance regulation, oversight, infrastructure, HR, and capital. Enhancing the involvement of associations and agents can effectively address problems related to supervision. Furthermore, it is imperative to implement comprehensive governmental restructuring to establish regulations, supervision, assessment of practicality, and a well-defined standard of healthcare. According to Wulandari and Kassim (2016), BMTs encounter difficulties in managing resources due to weaknesses in management, serving multiple microenterprises, rising operating costs, decreased profitability due to zakat obligations, increasing employee salaries and allowances, and the dual responsibilities and tasks of managers. Despite the implementation of several programs by BMT to reduce the frequency of these issues, research findings indicate that agency problem persist inside BMT. Therefore, specific efforts or strategies are required to address these problems.

Based on the research results, BMT's strategy to minimise the occurrence of agency problem in micro-business financing includes two aspects, namely improving BMT Governance and Increasing HR Capacity and Sharia Financial Literacy. related to the first, namely improving governance, this is essential for the long-term viability of organizations or institutions, as it guarantees that the company's strategy is in line with its goals and maintains proper oversight within the organization (Kassim, Hassan & Kassim, 2018). MFIs need improved governance to manage internal operations, expand reach, and achieve long-term viability. Key concerns include program sustainability, high transaction costs, and knowledge asymmetry in rural financial markets. Innovative strategies can decrease transaction expenses and shift additional costs to clients (Kassim et al., 2018). This includes establishing clear regulations on financial services authority and establishing a clear SOP for FO. Financing analysis is also crucial, considering business conditions, guarantees, collateral value, and accounting information systems. Regular evaluations of BMT financing performance are essential for ongoing supervision and guidance. Representative administrators should be appointed in each branch area, and a central financial system can minimise fraud and optimise supervision. Sharia compliance is essential for minimising agency problem in contracts, especially for micro-businesses. BMT can strengthen maintenance financing by conducting officer visits, providing early warnings, and alternative assistance when needed. Regular supervision from management using random sampling can verify the validity of financing information reported by officers.

A standard proportion of financing officers to maximum members is needed, with the number of employees in each office varying depending on the transaction scope.

Regarding increasing human resource capacity and Sharia financial literacy, it is not only necessary to increase BMT HR, but also BMT members and the community. This adopts a personal and family approach, focusing on building relationships and understanding potential financing members. This approach is beneficial for securing rewards and promotions, as it builds trust and commitment. Prospective financing members should be market-acceptable and have business skills, as they are more likely to manage risks. BMT can implement a group approach, involving mandatory training and weekly community learning (halaqah) supervision. Friendship visits, daily visits, and pick-up services for members' savings and instalment funds are also provided. Prizes for members with good track records can build emotional connections between the organization and its members. Social funds can be used to empower underprivileged individuals. Members with financing problems are encouraged to communicate intensively and provide guidance.

BMT's internal HR capacity is crucial for mitigating agency problem in micro-business financing. Recruitment strategies should focus on local community members, and spiritual training and guidance are needed for both BMT members and internal HR BMT. Collaborating with trusted community Figures can help BMT gain community acceptance and trust, especially for expansion areas or new branches. In addition, to increase public understanding of Islamic finance, BMT needs to implement a special program to educate members and the community about Sharia finance. This can be done through official programs, member assistance activities, and socialised programs. Collaboration with universities, religious and community leaders, policy makers, and other related parties can help socialise and increase public understanding.

To optimise the role and function of BMT, it is essential to foster synergy and collaboration with related institutions, including MSMEs and BMT associations. Lack of funds is a significant obstacle for BMT in carrying out coaching activities, necessitating government support in funding coaching activities. BMT should also collaborate with potential institutions like the creative economy ministry and NGOs to improve entrepreneurial skills in accordance with Sharia teachings. Collaboration with

BMT associations like FORKOPI, ABSINDO, PBMT, INKOPSYAH, and PUSKOPSYAH can provide coaching and training for both HR BMT and BMT members. The BMT association's tasks include education, facilitation, and advocacy. Collaboration between parties is needed to carry out the association's duties, particularly in education and facilitation for BMT members and the community and resolving legal problems for BMT members and the community. To minimize agency problem at BMT, several strategies carried out by BMT include improving BMT governance and increasing HR capacity and Sharia financial literacy among BMT HR, BMT members and the community (shown in Table 6.1). In implementing several of these activities, BMT synergises cooperation with related institutions. for example, in terms of improving governance, there needs to be clear regulations which require support from relevant policy stakeholders. In this case, BMT is divided into two, namely BMT as Sharia Savings and Loans and Financing Cooperative (KSPPS) and BMT as Sharia Microfinance Institution (LKMS).

Supervision by policy makers has an important role in the governance of an institution. The implications of improving BMT governance are also closely related to the existence of clear SOPs for BMT. There needs to be a clear SOP in every BMT activity such as Financing SOP, BMT Staff Recruitment SOP, BMT membership SOP, etc. This is not easy for BMTs, where the majority of BMTs only have general SOPs for activities which are also obtained from related institutions such as PINBUK and PBMT. This reality shows the need for synergy between BMT and related institutions in terms of creating SOPs according to the needs of each BMT. However, technically this is not easy to do because the number of BMTs is very large (3955 institutions) which are spread throughout all corners of Indonesia which have different cultures. In this case, the relevant institution can divide BMT into several types of characteristics. For example, this effort has been carried out by PINBUK which provides a definition of BMT as an integrated system of social financial services (Baitul Mal) and Sharia commercial financial services (Baitut Tamwil) that can be developed with various community approaches of BMT models. The implementation of these various BMT models has been implied so that in terms of SOPs they can be used as models to be implemented in other BMTs according to their respective model types. To realise this, there needs to be synergy between related institutions to optimise improvements in

BMT governance through the existence of clear and measurable SOPs in accordance with the characteristics of each BMT.

Financing analysis is important in BMT because it will have an impact on financing performance. Several BMTs that are the object of research pay special attention to the implementation of accurate financing analysis. However, there are still BMTs that do not pay much attention to the accuracy of financing analysis. As previously mentioned, BMT staff are sometimes faced with a dilemma where on the one hand the staff is trying to carry out an accurate financing analysis. On the other hand, these staff are faced with certain achievement targets regarding the amount of financing disbursed within a certain period which has an impact on the quality of the staff's performance. This condition is exacerbated by the reality that not all staff have good capabilities in terms of financing analysis. This last issue is a problem faced by BMT in general, namely that BMT has limited funds to recruit and provide decent salaries for highly capable HR in accordance with BMT's needs. This reality makes several BMTs found in research recruit low-capability HR who can then be trained after becoming BMT staff to increase the capabilities of BMT HR.

One of the BMT programs to minimise agency problem is by increasing Sharia compliance. However, not all BMTs pay attention to this aspect in implementing financing. The implementation of the financing agreement in accordance with Sharia provisions is given great attention even though it is not easy to implement with the challenge that not all members understand and can accept the implementation of this commitment. This is because the location of the BMT is near a shopping centre, namely a market in the middle of an urban community where many immigrants come from various cultural communities. On the other hand, the crime rate in urban areas tends to be higher compared to rural areas with most cultures from the same community. Regarding financing, the prediction is that the occurrence of deviant acts will be higher with the diverse characteristics of the population. However, this does not become an obstacle for the BMT to maintain Sharia compliance in every contract. Based on researchers' observations, the high level of commitment to Sharia compliance in BMT cannot be separated from two things, namely the historical founding of BMT which involved religious Figures with strong Islamic knowledge and the leadership Figure of the BMT chairman who had a high commitment to Sharia compliance which had an

impact. on the high level of commitment to Sharia compliance among BMT staff. The high level of confidence in the provisions of Allah SWT supports the high level of commitment to maintain Sharia compliance in the implementation of financing contracts amidst the challenge of not accepting these products in a society which incidentally has a low level of Islamic financial literacy.

At the beginning of implementing this commitment, several members changed institutions. However, as time went by, members began to be screened who also had a commitment to Sharia compliance and/or had high loyalty to the institution and remained members of the institution's financing. In addition, this also has an impact on reducing agency problem as evidenced by the decline in the NPF value compared to conditions where the institution does not pay too much attention to Sharia compliance in contract implementation. Another example is implemented by IMFIs<sup>5</sup>, which is one of the Islamic boarding school based BMT models. With the support of HR, almost all of whom are Islamic boarding school alumni and the location of the institution being close to the Islamic boarding school, the implementation of Sharia compliance at this institution is not as difficult as the previous institution which was a BMT - Company model. Apart from that, the location of the institution close to the Islamic boarding school has an impact on the environmental conditions of the religious community so that it is easier to accept offers of Islamic financial products. The strategic location in the middle of a supportive religious community keeps BMT alert. This is done partly because of the assumption that human faith can rise and fall, so it needs to be constantly reminded and directed towards the right path.

On the other hand, in the context of financial problems, humans can do deviant things if there are supportive opportunities. With this assumption, BMT is still implementing several coaching, mentoring and capability enhancing programs for both BMT staff and members and is also supported by a good system to cover every opportunity for deviation. In terms of technology utilization, all BMTs that are the object of research have utilised technology. However, each institution is different in using digitalization of the system. In this case, six systems were found used by BMT, namely system server, financial bookkeeping system, central financial system, Mobile AO/Mobile Marketing, Mobile BMT, and Mobile Printer. In terms of system servers, all BMTs that are the object of research use system servers, but most BMTs use system

rental facilities at BMTs or other institutions that provide system servers for BMTs. In terms of renting system servers compared to having their servers, each has its advantages and disadvantages.

The cost of renting a server is much cheaper than buying your server. On the other hand, on rented system servers, if a problem occurs you need to contact the server owner, which sometimes takes time to get a response. This is different from BMT which already has its server, which has greater flexibility in terms of setting up the required server system and responding directly if a disruption occurs. Ironically, of the eight BMTs that were the object of research, only two BMTs had their system servers. This reality is a separate note to examine further the issues and challenges of system server ownership at BMT. Apart from that, related institutions such as BMT associations and policy makers can also contribute to system server support for BMT in Indonesia.

This needs special attention because in the research it was also found that based on information from several participants in central Indonesia, there are still BMTs that use manual systems and when there are programs related to support systems from BMT associations or the government, not all BMTs have the awareness to take part in this program considering the high costs that will be incurred for the system. even though, based on participants' opinions, the benefits obtained by using the system are greater than the costs incurred. On the other hand, the use of a manual system will open up more opportunities for accidental data input errors and/or deliberate data manipulation by BMT staff. for the bookkeeping system, all BMTs use a bookkeeping system, however, the bookkeeping systems used by these BMTs are different.

The use of a computer bookkeeping system is felt to be very helpful for BMT's performance, especially in terms of recording financial transactions. Compared to manual bookkeeping systems which require more effort in terms of time, energy and mental concentration, computer bookkeeping systems are considered more effective and efficient. In addition, transaction data input errors, whether intentional or unintentional, can be minimised. Even though the system used by BMT is not as sophisticated as the system used by banks, the use of a computer bookkeeping system is a distinct advancement for BMT where there is already awareness to increase the effectiveness and efficiency of performance with digital systems. This is because there

are still BMTs that use manual bookkeeping systems, as explained by one of the informants that there needs to be support for policy stakeholders and related institutions in terms of socialization and support for the digitalization of the BMT system.

Another system used by BMT is the central financial system where the financial system at each branch at a particular BMT is centralised and connected to the financial system at the BMT head office. Based on research results, only one BMT uses this system, namely IMFIs, which has many branches spread across several provinces in Indonesia over long distances. Based on participant information, this centralised financial system is one of BMT's efforts to improve the financial supervision and transparency system and close the opportunity for irregularities, misuse or embezzlement of funds which may occur at branch offices due to weak or inaccessible supervision from the head office. However, procuring this centralised financial system requires large costs and not all BMTs have sufficient funds to procure the system.

Another system used by BMT is the Account Officer (AO) / Marketing Mobile application, which is one of the digital media used by BMT officers to input member transaction data while on duty in the field. This system is used in the five BMTs that are the object of research, while the other three BMTs do not use this application. The third reason BMTs do not use the application is because they do not know that the application exists and there has been no socialization regarding the application. Apart from that, based on information from BMT field officers, they felt more comfortable using a manual system for recording transactions in the field. This is felt by young officers and even more so by older field officers who are not technologically literate and therefore may not be able to operate the application in the field where conditions tend to be crowded with people, such as in markets and shopping centres. This reality indicates the need for special socialization to be able to introduce the benefits and obstacles in adopting a new system in an institution such as BMT.

The benefits felt from using the Mobile AO/Marketing application are time efficiency in synchronising transaction data recaps in the field and minimising the occurrence of data input errors, whether intentional or unintentional. This is because transaction data inputted in the field in real time can be entered into the BMT master data so that members can check their transaction activities via printed transaction slips

provided by BMT officers directly in the field, members check via the BMT mobile application, or members come by. directly to the BMT office. However, sometimes there are still some technical problems using this application system which are also sometimes related to the system server on the BMT.

Another system used by BMT is BMT Mobile, which is an application intended for BMT members to be able to carry out transactions and check transactions online via cell phone. This application provides services to members to be able to carry out transactions such as transferring funds between BMT accounts or to certain bank accounts depending on the type of BMT mobile application used on the BMT. Members can also see the history of transactions that have been made and payments for electricity, PLN, etc. This service can increase the transparency of member transactions, close the opportunity for embezzlement of funds by BMT staff in the field, and is expected to increase member awareness to be more disciplined in making payments on their financing instalments.

Based on research results, all eight BMTs provide this application service to their members. However, in practice, not all BMTs actively socialise and use this application for members. Apart from that, the type of mobile BMT used by each BMT is also different which is also related to the system server used. IMFIs6 uses two types of BMT mobile applications with services that complement each other. Both types of applications are still used with the consideration that some members have used the previous application where their data has been recorded so that all members are still given the opportunity to use both applications. This reality indicates the need for an application system that can automatically recapitulate data from previous applications. In this way, one application can provide more complete services while still being able to recapitulate data stored in the previous application.

Another case occurred at IMFIs7 and IMFIs8 where the BMT Mobile service was not actively used because there were still system access problems. On the other hand, not all members have compatible mobile devices to access the BMT Mobile application. Apart from that, the BMT mobile application can only be accessed by members of a certain age range who can read and write. This is a particular challenge for BMT, where most of its members are market traders who have low education or

even no education and cannot read and write. Another system used by BMT is a mobile printer which is a portable printout for printing proof of member transactions in the field. This service can increase the transparency of financial transactions in the field because members can get proof of their transactions directly in the field through transaction receipts printed by officers in the field.

For BMT members, the majority of whom are market traders who are busy with their respective business activities, this facility is very useful for maintaining transaction transparency without needing to check transaction history via BMT mobile. However, only 50% of the BMT research objects use this facility. The main reason this facility has not been/is not used is because the BMT is still comfortable using a manual recording system using slips and deposit/instalment cards in addition to the lack of or no socialization regarding the mobile printer facility. Based on the explanation regarding the system used by BMT, although it is not as sophisticated as the system used in banks, each BMT has utilised system digitalization in their transaction activities. It is felt that digitalization of the system has the benefit of increasing the transparency of financial transactions at BMT which will also minimise the occurrence of agency problem in financing at BMT. However, not all BMTs use the six systems mentioned in this research. Apart from that, each system used by BMT has advantages and disadvantages which still require support from both institutions related to BMT and related policy makers.

As mentioned in the previous discussion, one of the agency problem that occurs in financing at BMT is caused by the low capability and literacy of Islamic finance in both BMT HR and BMT members. This is an issue for BMT which has limited funds for coaching, training, mentoring and supervision activities. However, based on the research results, it was found that several BMT activities were carried out in the context of increasing Islamic financial capacity and literacy. Based on research data, capacity building and Islamic financial literacy activities can be seen in Table 6.1.

Table 6.1 BMT Capacity Building and Islamic Financial Literacy Activities

No	Object	Activity	IMFIs 1	IMFIs 2	IMFIs 3	IMFIs 4	IMFIs 5	IMFIs 6	IMFIs 7	IMFIs 8
1.	BMT staff	Coaching	v	-	v	v	v	-	-	v
		Training	v	v	-	v	v	v	v	v
2.	BMT member	Coaching	v	v	-	v	v	v	-	-
		Training	v	-	-	v	v	v	-	-
		Mentoring	v	-	-	v	v	v	-	-

Source: Main Data (Processed by The Author)

It can be seen from Table 6.1 of the eight, only three BMTs have coaching and training programs for BMT staff as well as coaching, training, and mentoring programs for BMT members. IMFIs6 has three special programs for members, namely in the form of coaching, training, and mentoring, IMFIs2 only has a special program for BMT members in the form of coaching, while IMFIs3, IMFIs7, IMFIs8 have no special program for BMT members. As for special programs for BMT staff, IMFIs8 has a coaching and training program, IMFIs2, IMFIs6, IMFIs7 only has a training program, and IMFIs3 only has a coaching program.

This data shows that not all BMTs have special attention in terms of increasing Islamic financial capabilities and literacy for the HR of their institutions. Moreover, regarding special programs for BMT members, three BMTs have no special programs for BMT members in the form of coaching, training, and mentoring. Some of the obstacles found in several BMTs in having special programs for members are the importance of special activities in the form of coaching, training, and mentoring. Increasing Islamic financial capacity and literacy is part of education that is highly considered in Islam.

Based on the previous discussion, there are two main factors that impact the occurrence of agency problem at BMT, namely related to the weak and poor BMT governance system, and low human resource capacity and Islamic financial literacy for both BMT and its members. There have been several efforts made by BMT to minimise agency problem through the programs implemented. However, based on research results, BMT still faces agency problem, namely in the form of adverse selection, moral hazard, and untrustworthy behaviour. Based on this reality, it is necessary to investigate further whether each BMT has a program related to these two main factors.

## 6.6 CONCLUSION

Agency problem in micro-business financing at BMT demonstrate the validity of agency theory in IFIs. These problems can occur due to non-adherence to Islamic teachings, which emphasise the importance of relationships between various entities. The principal-agent relationship in Islamic economics is limited due to conventional views and empirical works. Lack of Sharia compliance in implementing financing contracts and members' lack of morality trigger four types of agency problem in micro-business financing at BMT. BMT has implemented programs to minimise agency problem, but implementation varies among BMTs. The main reasons for this imbalance are obstacles, lack of management, and a shortage of qualified HR, particularly in eastern Indonesia. BMT's strategy focuses on improving governance, increasing HR capacity, and Sharia financial literacy. This includes building relationships, understanding financing members, securing rewards, promoting risk management, and implementing group training, supervision, and rewards. Social funds can empower underprivileged individuals and encourage communication.

# CHAPTER SEVEN

## CONCLUSION

### 7.1 INTRODUCTION

This section presents highlights of major findings, implications, recommendations, and research limitations along with suggestions for further research. Based on the research results, the findings in this study also offer several implications in terms of theory, methods and practice which will be discussed.

### 7.2 HIGHLIGHTS OF MAJOR FINDINGS

Departing from agency theory and its implications for contracts according to Islamic principles in Islamic microfinance institutions, this research aimed to investigate agency problem, factors that affect to the occurrence of that issues, and solutions in the context of Islamic financial contracts for micro-business financing in BMT. The research method used was qualitative through interviews with 85 participants who were practitioners from certified active Sharia cooperatives and part of the oldest BMT established in each province, as well as experts from regulators and academics, and strengthened by surveys, observations, and document analysis. The highlight of the major findings of the research is shown in Table 7.1.

Table 7.1 Research Objective, Major Findings, and Implication

No	Research Objectives (RO)	Major Findings	Implication
1	To identify the agency problem faced by BMT in providing financing to microenterprises in Indonesia.	<b><u>Existing agency problem</u></b> 1) Adverse selection 2) Ex-ante moral hazard 3) Post-ante moral hazard 4) Untrustworthy behaviour → Agency theory validity evidence → Lack of Sharia compliance	<b><u>Practical</u></b> 1) The need to understand, pay attention to and fulfil financing contract agreements on the part of BMT staff and members. 2) The importance of orientation to ownership of a permanent place of business for microenterprises. 3) The need for awareness to change the paradigm of thinking in accordance with Islamic

No	Research Objectives (RO)	Major Findings	Implication
			<p>principles starts from the staff side to be conveyed to BMT members.</p> <p><b><u>Theoretical</u></b></p> <p>1) Existing agency problem - asymmetric information on two sides: BMT staff (untrustworthy behaviour) and BMT members (adverse selection and moral hazard).</p>
2	<p>To investigate the reasons why agency problems still occur at BMT in providing financing for micro entrepreneurs in Indonesia.</p>	<p><b><u>Factors that affect the existence of agency problems</u></b></p> <p>1) BMT HR and Governance (selection process, BMT HR capacity, weak supervision system, and poor BMT Governance)</p> <p>2) BMT member factors (member character and member's lack of understanding of Islamic finance.</p> <p>→ Main affecting factors: lack of Sharia compliance and members' lack of morality.</p> <p>→ Psychological affecting factor finding.</p>	<p><b><u>Practical</u></b></p> <p>1) The importance of emphasising the implementation of Sharia compliance in financing contracts and coaching micro entrepreneurs, especially regarding the implementation of Islamic business ethics.</p> <p><b><u>Theoretical</u></b></p> <p>1) Two main affecting factors of agency problem: governance and HR.</p> <p>2) Indication of psychology factor effect on adverse selection.</p>
3	<p>To evaluate efforts implemented by BMT to minimize the agency problem faced by BMT in providing financing to microenterprises in Indonesia.</p>	<p><b><u>Implemented program of BMT</u></b></p> <p>1) BMT governance improvement (clear standardization and measurable SOPs, routine evaluation, task division delegation, and system digitalization)</p> <p>2) HR BMT capacity building (training and spiritual touch)</p> <p>3) Training, coaching and mentoring members.</p> <p>→ Equality and lack of implementation of the program.</p>	<p><b><u>Practical</u></b></p> <p>1) The need for BMT role models in terms of program implementation.</p> <p>2) BMT governance impacts the performance of financing implementation for micro-businesses.</p> <p>3) HR capacity building program through coaching, mentoring, and training gives a better understanding to both BMT staff and members.</p> <p>4) Technology incorporation for governance improvement.</p> <p><b><u>Theoretical</u></b></p> <p>1) Governance and HR improvement to mitigate agency problem.</p>
4	<p>To propose a strategy on how to overcome agency problem faced by BMT in providing financing to microenterprises in Indonesia.</p>	<p><b><u>BMT's strategy</u></b></p> <p>1) BMT governance improvement - long-term organizational viability, strategy alignment with goals and organization proper oversight.</p> <p>2) HR capacity building enhancement - problematic underprivileged individuals, and members empowerment and encouragement.</p>	<p><b><u>Practical</u></b></p> <p>1) Governance and HR capacity building improvement policy design.</p> <p>2) Financial inclusion national strategy for IMFI.</p> <p>3) Related parties' synergy and collaboration (e.g. educational institutions, and policy makers).</p> <p><b><u>Theoretical</u></b></p> <p>1) Agency problem solution model.</p>

No	Research Objectives (RO)	Major Findings	Implication
		3) Sharia Financial Literacy improvement. 4) Community-based approach. → The need for synergy and collaboration.	2) Meeting point explanation with different approach analysis.

Source: Main Data (Processed by The Author)

Table 7.1. briefly explain the agency problem that exists in microenterprise financing of BMT, namely adverse selection, ex-ante moral hazard, post-ante moral hazard, and untrustworthy behaviour among management staff. Adverse selection in micro-business financing can lead to inaccurate applications and unfair treatment. Members may not disclose their needs or dependents, causing inaccurate financing applications and unfair treatment. Non-fixed business locations pose a higher risk, and moral hazard may occur if a member deliberately runs off with funds or moves else without notifying BMT. Misuse of financing fund allocation by members can result in bankruptcies or ex-ante moral hazard in murabahah bil wakalah contracts. Post-ante moral hazard occurs due to asymmetric information, affecting adverse selection and ex-ante moral hazard. Members with bad behaviours can take funds away after disbursement, avoid BMT officers, divert conversations, or falsify ownership documents. Research have shown instances of untrustworthy behaviour among BMT employees, including collaboration with members, holding funds in personal names, and receiving promotions and bonuses. Profit-sharing-based financing involves BMT employees covering information about members' business losses to avoid scolding from superiors. Murabahah financing involves marketing or BMT officers covering the cost price of the financing object. Agency problem in eight BMTs, including selection, ex-ante and post-ante moral hazard, and untrustworthy behaviour, suggest that individuals' self-interest remains a significant assumption in agency theory.

Microenterprise financing at BMT faces agency problem due to various factors, including HR and governance issues, member factors, and inaccurate financing analysis. Business conditions such as layoffs, COVID-19, and natural disasters contribute to these issues. The BMT officers' knowledge of financing analysis is questionable, and communication skills among members can lead to information hiding. The loose financing system creates opportunities for misuse of funds and collateral

embezzlement. BMT faces challenges in its HR department due to limited capacity and inaccurate financing analysis standards. Lack of supervision can lead to improper instalments, civil disputes, and asymmetric information. Poor governance issues include poor management, system weaknesses, and agency problem. Some BMTs still use manual systems, leading to untrustworthy behaviour and civil disputes. Non-compliance with Islamic Sharia principles can result in inappropriate contract selection and weak emphasis on contracts during surveys. Ununderstood financing agreements and a lack of Sharia financial education among members and society highlight the need for optimal development of BMT. Agency problem among BMT, its staff, and members are influenced by factors due to BMT staff and members. Conventional and Sharia transaction paradigms differ, but many Sharia transactions still rely on a conventional mindset, causing information asymmetry, adverse selection behavior, and moral hazard. This highlights the existence of assumptions in agency theory.

The BMT Program aims to improve governance and address agency problem by standardising clear and measurable SOPs. It has approved SOPs for staffing and financing, with financing staff limited to specific targets. Regular evaluations and task delegation between administrators and managers ensure growth and financial issues are addressed. BMT increases HR capacity through online or offline training, including Sharia finance, bookkeeping, finance, training, and information system facilitation. Internal training covers topics like product introduction, contract patterns, financing, and leadership. Spiritual touches are implemented to maintain trust. HR capacity building activities vary among BMTs, but funding constraints and pandemic conditions pose challenges. BMT officers conduct member coaching and mentoring activities through daily visits, providing services, and understanding contracts and financing mechanisms. BMTs provide various training programs for members, including MSME training by IMFIs and IMFIs, and direct guidance through field officers. Despite challenges, BMTs continue to strive for better member support and participation. Judging from the BMT program in minimising agency problem, it shows that there have been efforts by BMT to change the thinking paradigm of conventional transactions to Sharia transactions.

BMT, a Sharia cooperative, is implementing a strategy to address agency issues in micro-business financing. The plan includes improving governance, increasing HR

capacity, and enhancing Sharia financial literacy among BMT, members, and the community. The plan includes preparing a good management system, establishing clear regulations, and having clear SOPs for each BMT, particularly those relating to financing activities. Improving financing analysis is crucial to minimise agency problem and ensure accurate results. Regular evaluations of BMT financing performance can be conducted through a community-based verification strategy. Sharia compliance is crucial for successful implementation of contracts in Islamic finance. The BMT is focusing on improving its financing system through regular staff visits and tightened supervision. Enhancing HR capacity and Sharia financial literacy is also essential. Recruitment strategies, coaching, mentoring, and training for members and internal HR are also being implemented. Special programs and collaboration with universities, religious and community leaders, and policymakers are also needed to increase public understanding of Islamic finance. The BMT program's optimal implementation requires synergy and collaboration between related institutions. The statement supports the idea that cooperation, collaboration, and mutual assistance are the primary economic strengths. The principle of family, which entails companionship, mutual help, and working together, aligns with the Prophet's hadith, which states that Allah always helps people if they always help their family.

The agency problem model on its evidence, affecting factors, and solution can be seen in Figure 6.1.

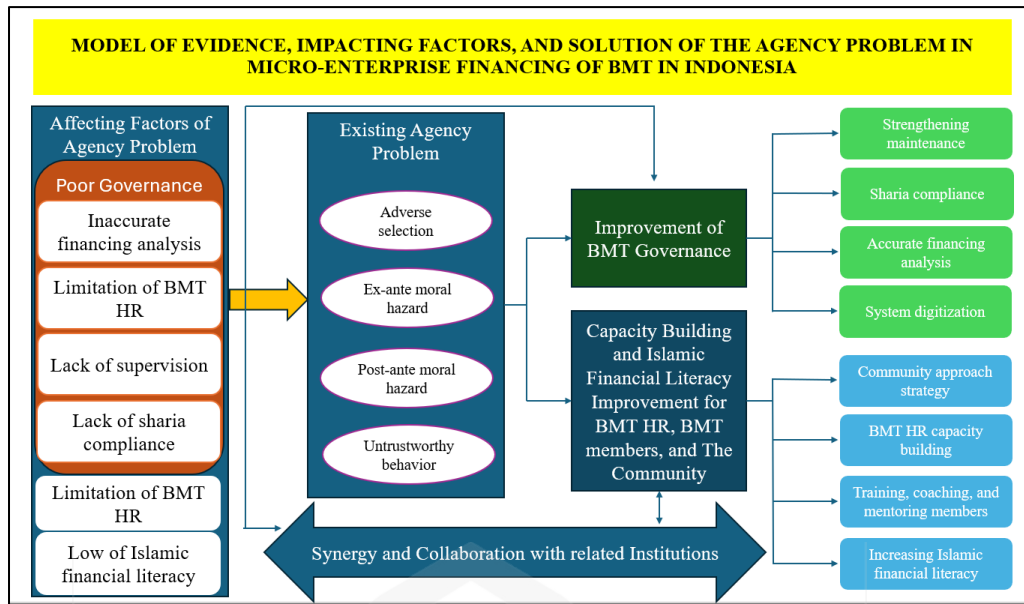


Figure 6.1 Evidence, Affecting Factors, and Solution of the Agency Problem Model

### 7.3 IMPLICATIONS

The study highlights practical implications regarding the importance of understanding and fulfilling financing contact agreements among staff and members of Islamic cooperative microfinance institutions (BMTs) and the need for a permanent place of business. It emphasises the need for a shift in thinking towards Islamic principles, emphasising Sharia compliance in contract implementation and coaching micro entrepreneurs on Islamic business ethics. A BMT should serve as a model for program implementation, socialising it as a role model for all BMTs in Indonesia. Improving BMT governance is crucial for financing implementation performance. Human resource capacity building through coaching, mentoring, and training can increase Islamic financial literacy and institutional understanding. Technology incorporation for governance improvement is also suggested. A national strategy for financial inclusion should involve BMT and related institutions, fostering synergy and collaboration between BMT, associations, educational institutions, and policy makers. The study also suggests that low Sharia financial literacy among BMT staff and members can impact agency problem and BMT's financing performance. Policymakers should provide clear regulations and support BMT's existence and development, empowering the economy of lower middle-class communities, including micro entrepreneurs. The research uses qualitative methods to explore agency problem in microenterprise financing in Islamic cooperative microfinance institutions.

Agency problem in microenterprise financing at BMTs can arise due to asymmetric information on two sides, namely BMT staff and BMT members. These problems are influenced by three main factors: governance, HR, and Islamic financial literacy. Psychological factors also play a role in the occurrence of adverse selection. To mitigate these issues, BMTs should improve governance, increase human resource capacity, and enhance Islamic financial literacy. Several BMTs have implemented initiatives to address agency concerns, such as enhancing governance, bolstering personnel capabilities, providing coaching and mentoring, conducting member training, fostering synergy and collaboration with other institutions, and using digitalization systems. However, not all BMTs execute the protocol optimally. The goals and advantages of the program vary based on the level of work exerted by each BMT in fully implementing the program. Suggested solutions to address agency problem include implementing explicit regulations, ensuring compliance with Sharia principles, conducting thorough financial analysis, adopting community-based verification methods, and enhancing Islamic financial literacy among BMT personnel, members, and the wider society. Thus, the theoretical implication of the research is to increase knowledge and deeper understanding of agency problem, influencing factors, and how to solve these issues in microenterprise financing at Islamic microfinance institutions in the form of cooperatives. It also explains the meeting point of perceptions of practitioners, academics, and policy makers regarding research issues.

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#### **7.4 RECOMMENDATIONS**

The study highlighted that agency problem persists in microenterprise financing in BMT. To address these issues, it is imperative that BMTs and micro-entrepreneurs are not given the autonomy to resolve difficulties independently. Regulatory clarity and enhancement of the supervisory structure for BMTs require support from all

stakeholders, including regulators. Collaboration between BMT associations and other relevant institutions can enhance HR capabilities and enhance governance. Furthermore, it is crucial to establish collaboration between institutions to enhance Islamic financial literacy among both the workforce in IFIs and the public.

## **7.5 LIMITATIONS AND SUGGESTIONS FOR FUTURE RESEARCH**

As a qualitative study, this research was constrained by the limitations of qualitative inquiry. The findings are mainly based on the subjective analysis of the researcher. Thus, the analysis may be subjected to researcher bias. The researcher acknowledges that as an integral part of the process of qualitative inquiry, personal experiences, expectations, prior knowledge, and biases of the researcher may interfere with the process of data collection and analysis. Although peer reviews were utilised to check the analysis in terms of biases and consistency, other supportive techniques such as member checking (Cresswell & Miller, 2000), asking participants to verify the researcher's understanding of the interview contents would further help to reduce possible researcher bias. However, due to the practical geographical difficulties in reaching out to the participants for the second time, member checking technique could not be utilised in the present study.

Responding to these limitations, researchers used other methods to increase the validity and reliability of data and research results, namely using data triangulation supported by using more than one technique and confirming the coding results with three experts in the field of Islamic microfinance. On the other hand, mixed method studies combining both quantitative and qualitative techniques of analysis would offer richer data and more sustainable information on the agency problem in the microenterprise financing of BMT. The study suggests that quantitative research using advanced statistical methods could test emerging theoretical models and reveal casual relationships between variables. It suggests that future research could enhance the significance of findings by using consistent methodologies in diverse settings or varied methodologies within the same research environment. Comparative studies of agency problem in commercial contracts and non-commercial contracts, as well as in cooperative BMT and Sharia MFIs BMT, could be conducted. The study also suggests

the need to generalise research results related to factors affecting the occurrence of agency problem using quantitative methods. Psychological factors, from the perspective of BMT members, could be a significant factor in adverse selection in micro-business financing in BMT. More in-depth research related to this matter could provide interesting discourse on this research topic.



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# APPENDIX I

## DATA COLLECTION PROCEDURE FORMS



(Company No. 100067-01)

IIUM INSTITUTE OF ISLAMIC BANKING AND FINANCE (IIBF)



Date: November 11, 2022

To Whom It May Concern

Assalamu'alaikum warahmatullahi wabarakatuh

Dear Sir / Madam,

### RECOMMENDATION LETTER FOR DATA COLLECTION

This is to certify that Andri Martiana, (IIUM Matric No: G1915700) is currently pursuing her **Ph.D** in Islamic Banking and Finance at IIUM Institute of Islamic Banking and Finance (IIBF), International Islamic University Malaysia. She is conducting research entitled "Agency Problems in Micro-enterprise Financing of Baitul Maal wa Tamwil (BMT) in Indonesia" under my supervision.

We are writing to request permission for Andri Martiana to collect data from your institution. Kindly render necessary assistance to her in the data collection process which is necessary for the completion of her research work.

We assure you that all information obtained will be treated as private and confidential and will only be used for research purposes.

Your support is highly valued and appreciated.

Thank you. **Wassalam**

Yours sincerely,

PROF. DR. SALINA HJ. KASSIM  
Main Supervisor  
IIUM Institute of Islamic Banking and Finance (IIBF)

Cc: Head of      / Manager of ...



CERTIFIED TO ISO 9001:2015  
For Information No. 438/2021

*Garden of Knowledge and Virtue*

Office Address: IIUM Institute of Islamic Banking and Finance (IIBF), International Islamic University Malaysia, Jalan Gombak, 53100 Selangor Darul Ehsan.

Mailing Address: IIUM Institute of Islamic Banking and Finance (IIBF), P.O. Box 10, 50728 Kuala Lumpur, Malaysia

Tel: +603-6196 4183 | Fax: +603-6196 4856 | Website: www.iium.edu.my/iibf

## Expert Validation Survey

Dear Expert,

Let me introduce myself, my name is Andri Martiana, a doctoral student at the Institute of Islamic Banking and Finance (IIBF), International Islamic University Malaysia, Kuala Lumpur, Malaysia (IIUM). Currently, I am working on my doctoral thesis on the topic "Agency problem in Micro-business Financing at Baitul Maal wa Tamwil (BMT) in Indonesia." I will facilitate validation sessions from these experts/experts as one of the stages in preparing my doctoral thesis.

This theme is based on the researcher's enthusiasm for BMT, which is a Sharia microfinance institution in Indonesia with a dual role, namely commercial and social functions. Based on the existing literature review, BMT plays a role in empowering the people's economy, one of which is through financial services and providing access to financing for the poor. However, BMT faces many obstacles in carrying out its operations, including those related to the selection (screening) process for customers who will become partners, the implementation of credit-plus financing, and the problem of default among poor borrowers, one of which is caused by moral hazard actions. This research aims to explore agency problem, investigate the role of programs that have been carried out to deal with agency problem, and propose solutions to agency problem in micro-business financing at BMT in Indonesia.

To make it easier to complete, before you answer this survey question, you will be presented with a brief explanation regarding several summaries of the literature used in this research. There are two types of questions in this survey, the first is a multiple-choice question which states whether the question item is valid or invalid. The second question is a fill-in question which contains comments from experts/experts regarding the editorial of the question and whether the content of the question item is appropriate and appropriate or not. Completing this survey takes a maximum of 45 minutes.

All answers provided will be kept confidential and only used for research purposes. Your kind cooperation in answering these survey questions is greatly appreciated.

Thank You

**Research conducted by:**

Andri Martiana  
PhD Candidate,  
Institute of Islamic Banking and Finance IIUM (IIiBF),  
International Islamic University Malaysia,  
Gombak Road,  
53100 Selangor Darul Ehsan,  
Kuala Lumpur, Malaysia

**Supervisor:**

Professor Dr. Salina Kassim  
Institute of Islamic Banking and Finance IIUM (IIiBF),  
International Islamic University Malaysia,  
Gombak Road,  
53100 Selangor Darul Ehsan,  
Kuala Lumpur, Malaysia

Assoc. Prof. Dr. Habeebullah Zakariyah  
Institute of Islamic Banking and Finance IIUM (IIiBF),  
International Islamic University Malaysia,  
Gombak Road,  
53100 Selangor Darul Ehsan,  
Kuala Lumpur, Malaysia

**Part A: Participant Demographic Information**

Please write your name:

Please write your initials:

Please write your affiliate organization:

Gender:

- Male                       Female                       Others

Field of Expertise (Can choose more than one)

- Economics               Finance                       Accounting                       Islamic Economics  
 Islamic Finance       Islamic Accounting       Others,  
Please mention: \_\_\_\_\_

Please indicate whether you have worked/explored this field since: \_\_\_\_\_

Please include your academic/lecturer/researcher/practitioner experience:

- 0 to 3 years       4 to 7 years       8 to 11 years       12 to 15 years       more than 15 years

Work experience (can choose more than one):

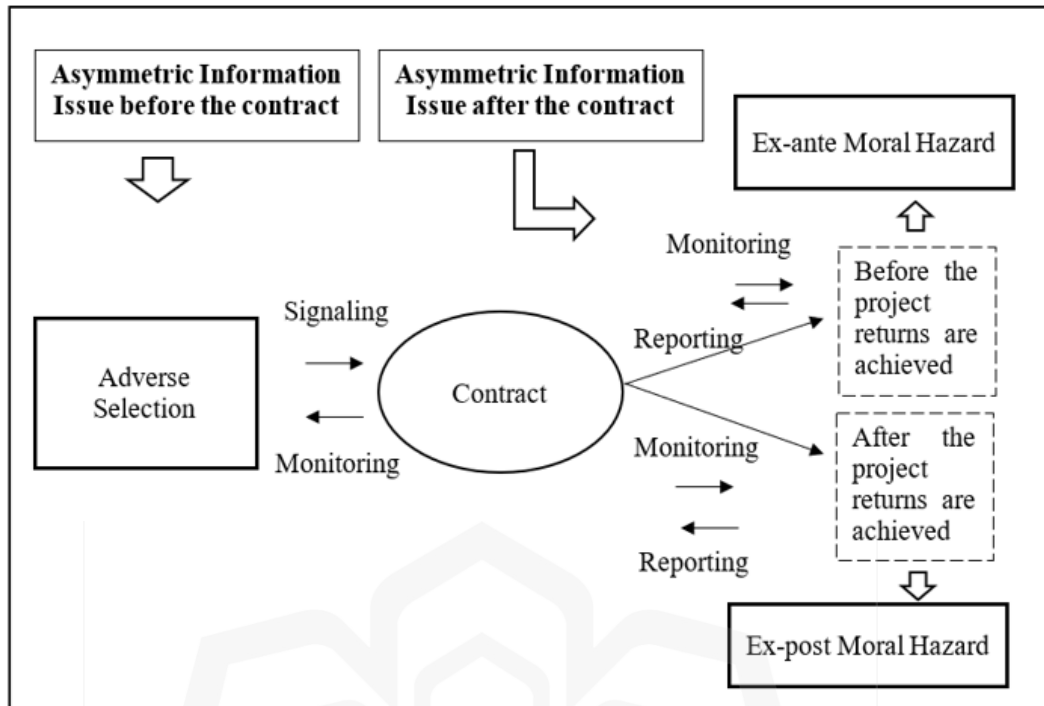
- Academics       Lecturers       Researchers       Practitioners       Others,  
please mention: \_\_\_\_\_

## Part B: Explanation of Agency problem in Microenterprise Financing

Agency problem is a challenge for financial institutions operating in the micro sector. The inability of lenders to monitor borrower characteristics (e.g., project risk), borrower effort, or profitability is an asymmetric information problem that can lead to inefficiencies in the microcredit market, even if microfinance can be considered an attempt to overcome these problems. The "principal" (lender) enters business collaboration with an "agent" which in practice can trigger agency problem.

Agency problem caused by asymmetric information can occur in three stages. First, namely problems that arise before the lender (principal) provides a loan to the borrower (agent). Second, once a loan is approved, the lender does not know how the borrower will use the funds. Third, once the rate of return is realized, the lender may not be able to verify the amount of the return. This leads to dishonest borrowers claiming bad luck (and asking for loan repayment delays) when in fact it is a very profitable investment, especially with minimal obligations to fulfil. By knowing a borrower's real income, lenders will be able to demand full repayment and apply penalties that can potentially deter future borrower misconduct.

A more detailed explanation regarding the comparison of adverse selection, ex-ante moral hazard, and ex-post moral hazard problems can be seen in Figure 1:



Source: Author and various sources (processed by the author)

Figure 1 Comparison of the Occurrence of Adverse Selection, Ex-ante Moral Hazard, and Ex-post Moral Hazard

Some of the literature studies used in this research can be seen in the following Table 1:

<b>Agency problem in Microenterprise Financing</b>		
<b>Author</b>	<b>Context</b>	<b>Idea</b>
Iqbal, 2006; Haron & Hock, 2007; Khan & Philips, 2010; Rahman, 2010; El Komi & Croson, 2012)	Islamic Microfinance Instruments	Several contracts have a lot of potential to be developed and adapted as Sharia microfinance schemes, namely: Mudarabah, Musyarakah, Murabahah, Ijarah, and Qardhul Hasan.
Siddiqi in Rahman, 2007	Basic Principles of Islamic Banking and Finance	Islamic finance is based primarily on the prohibition of usury and as an alternative to usury, contracts based on profit & loss sharing are one of the ideal models of financing in Islamic finance.
Sarker, 1999	Agency problem in microfinance institutions	Agency problem is a challenge for financial institutions operating in the micro sector. The inability of lenders to monitor borrower characteristics (e.g., project risk), borrower effort, or profitability is an asymmetric

<b>Agency problem in Microenterprise Financing</b>		
<b>Author</b>	<b>Context</b>	<b>Idea</b>
		information problem that can lead to inefficiencies in the microcredit market, even if microfinance can be considered an attempt to overcome these problems.
Nienhaus, 1983	PLS bank risks	PLS banks will attract applications with insider knowledge that their projects are very risky, and borrowers who will increase their profit expectations in the hope of getting a lower profit-sharing ratio by the bank.
Pryor, 1985	Benefits of PLS Financing for borrowers	Borrowers who expect their projects to provide high non-monetary benefits, but low realized profits will choose PLS financing because they will enjoy high total returns at an artificially low cost of capital.
Mills and Presley, 1998	The problem of adverse selection in banks	Banks' difficulty in determining the quality of loan applicants results in various adverse selection problems, especially when debt financing is available from competing sources.
Goodhart, 1987	The problem of moral hazard and adverse selection in Islamic banks	Islamic banks' vulnerability to moral hazard and adverse selection will likely make them uncompetitive with conventional rivals, due to additional fixed costs in information gathering and project assessment, reduced work incentives for entrepreneurs and higher production costs.
Sarker, 1999	Costly monitoring problems to minimize information asymmetry problems in PLS contracts	In a PLS contract, the borrower has every incentive to underreport or artificially reduce declared profits. They can lower profits by taking excessive extra income or extra free time or using accounting excuses. Therefore, Islamic banks have to incur expensive monitoring costs to ensure whether the stated profits truly reflect the activities or company/business project or not. This ex-post information asymmetry triggers moral hazard problems in Islamic banks.
Jensen & Meckling, 1976	Agency Theory	An agency relationship involves the transfer of some decision-making responsibilities to an agent. If both parties are utility maximizers, there is reason to think that the agent will not always operate in the best interests of the principal.
Syarifuddin & Abdullah, 2019	Agency Relations in the Qur'an	Potential agency conflicts in cooperation agreements.
<b>Strategies to Minimize the Occurrence of Agency problem</b>		
<b>Author</b>	<b>Context</b>	<b>Idea</b>
Jensen & Meckling, 1976	Incentives to minimize agency conflict	Principals can prevent conflicts of interest by providing appropriate incentives to agents and paying monitoring fees.

<b>Agency problem in Microenterprise Financing</b>		
<b>Author</b>	<b>Context</b>	<b>Idea</b>
Amin & Yusof, 2003	Allocative Efficiency of Profit Maximization in an Islamic Perspective	Consider ethical values to promote allocative efficiency in markets.
Mirakhor & Zaidi, 2009; Minhat & Dzolkarnaini, 2016	Alternative Sharia Financing Instruments	Although profit & loss sharing instruments such as musyarakah are widely accepted as an ideal form of Islamic financing, previous research shows that alternative instruments such as murabahah are preferred by Islamic banks.



**Part C: Main Survey (Please complete all questions)**

<b>Survey Questions</b>		
(Choose the answer that you think best describes the entire survey for each question)		
I. This complete survey shows the validity that each question item is appropriate and appropriate for exploring and investigating agency problem in BMT microenterprise financing in Indonesia.	1= Valid question item	2= Invalid question item
<p>Criticism of Survey Questions: Please answer questions with specific examples (if any) regarding the entire survey instrument.</p> <p>II. Does the survey meet the objectives of this research? Why or why not?</p> <p>III. Would you suggest any changes to the survey or presentation settings to make them easier to use?</p> <p>IV. Do survey items represent content validity? Content validity is whether the items on an instrument adequately model the targeted content area (Gable and Wolf, 1993, p. 96).</p> <p>V. Does the wording of the survey questions provide a clear and concise understanding of what each item is asking?</p> <p>VI. Are the items in the survey appropriate and suitable for exploring and investigating data related to agency issues and challenges in BMT microenterprise financing? Why or why not?</p> <p>VII. Additional Comments:</p>		

**PART A. PROBLEMS AND CHALLENGES RELATED TO AGENCY RELATIONSHIPS WHICH INCLUDE ADVERSE SELECTION, EX-ANTE MORAL HAZARD, AND POST-ANTE MORAL HAZARD ISSUES THAT EXIST IN MICRO-BUSINESS FINANCING IN BMT IN INDONESIA**

	Select the answer to validate whether the question item is appropriate and appropriate to explore and investigate	Is this question item appropriate and appropriate to explore and investigate agency problem in micro-	Do you have suggestions/input regarding the editorial questions to improve participants' understanding? Please provide specific feedback.
<b>Survey Items</b>			

	<b>agency problem in micro-business financing at BMT in Indonesia</b>	<b>business financing at BMT in Indonesia? Why or why not?</b>	
Item 1: What kind of contracts does BMT use to finance microenterprises?	1- valid		
	2- invalid		
Item 2: Of the many contracts that have been mentioned, which contract is the least popular (by customer partners and BMT) and the most problematic? Why?	1- valid		
	2- invalid		
Item 3: What agency problem have occurred and/or frequently occur in contracts used in micro-business financing? How does this agency problem occur?	1- valid		
	2- invalid		
Item 4: What are the challenges faced in agency relationships that have occurred and/or often occur in contracts used to finance these micro-businesses?	1- valid		
	2- invalid		
Item 5: What are the issues and challenges related to the problems of asymmetric information, adverse selection and moral hazard in micro-business financing in BMT? How can this problem occur?	1- valid		
	2- invalid		
Item 6: What parties have an influence in triggering agency problem in micro-business financing?	1- valid		
	2- invalid		

**PART B. STRATEGIES TO MINIMIZE AGENCY PROBLEM IN BMT MICRO-BUSINESS FINANCING IN INDONESIA**

Item 7: What is BMT's strategy/approach/program in dealing with agency problem that occur in micro-business financing? Have all these strategies and/programs been implemented?	1- valid		
	2- invalid		
Item 8: What obstacles and challenges do BMT face in implementing these programs? How do customer partners respond to the program?	1- valid		
	2- invalid		
Item 9: What strengths does BMT have in overcoming agency problem in micro-business financing?	1- valid		
	2- invalid		
Item 10: What opportunities does BMT have in overcoming agency problem in micro-business financing?	1- valid		
	2- invalid		
Item 11: Does BMT also have group lending and joint liability programs? If yes, what is the mechanism?	1- valid		
	2- invalid		
Item 12: Does BMT also have a social coaching program? if so, what is the mechanism?	1- valid		
	2- invalid		
Item 13: What are the advantages and/or differences between this program and programs at other Sharia microfinance institutions or conventional microfinance institutions?	1- valid		
	2- invalid		
Item 14: What is the selection or screening process for BMT micro-business financing customers?	1- valid		
	2- invalid		

Item 15: Does BMT require collateral in providing financing for micro-businesses? If yes, what is the form and mechanism for applying for the guarantee?	1- valid		
	2- invalid		
Item 16: What is BMT's strategy for dealing with micro-business financing customers who do not have collateral? Is there a policy for applying social security to BMT? If so, how is it implemented?	1- valid		
	2- invalid		
<b>PART C - THE ROLE OF STRATEGIES CARRIED OUT BY BMT IN MINIMISING AGENCY PROBLEM IN MICRO-BUSINESS FINANCING</b>			
Item 17: What is the influence of the strategy implemented by BMT in minimising the occurrence of agency problem in micro-business financing?	1- valid		
	2- invalid		
Item 18: What are real examples of the success of the BMT strategy in minimising agency problem in micro-business financing?	1- valid		
	2- invalid		
Item 19: To what extent does the screening process/mechanism implemented by BMT have an effect in minimising agency problem in micro-business financing?	1- valid		
	2- invalid		
Item 20: What is the effect of obligations on collateral in minimising the occurrence of agency problem in micro-business financing?	1- valid		
	2- invalid		
Item 21: What is the role of social security in minimising the occurrence of agency problem in micro-business financing?	1- valid		
	2- invalid		

Item 22: How do group lending and joint liability programs influence minimising agency problem in micro-business financing?	1- valid		
	2- invalid		
Item 23: How does the social development program influence minimising agency problem in micro-business financing?	1- valid		
	2- invalid		
<b>BAGIAN D – SOLUSI PERMASALAHAN KEAGENAN DALAM PEMBIAYAAN USAHA MIKRO PADA BMT DI INDONESIA</b>			
Item 24: What strategies/programs can be offered to be a solution to agency problem in micro-business financing at BMT?	1- valid		
	2- invalid		
Item 25: To what extent does the screening process, collateral obligations and/social security implemented by BMT play a role in minimising the occurrence of agency problem in micro-business financing?	1- valid		
	2- invalid		
Item 26: To what extent can group lending and joint liability programs be a solution to agency problem that occur in micro-business financing at BMT?	1- valid		
	2- invalid		
Item 27: To what extent can social development programs be a solution to agency problem in micro-business financing in BMT?	1- valid		
	2- invalid		
Item 28: To what extent can technology or system digitalization minimize agency problem in micro-business financing in BMT?	1- valid		
	2- invalid		
	1- valid		

Item 29: What are the suggestions for BMT's future strategic plans to overcome agency problem in micro-business financing?	2- invalid		
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**Thank you very much for your time and participation!**



## PILOT STUDY INTERVIEW PROTOCOL

Organization & Location:

Date/time:

Participant Name:

Researchers conduct sessions:

Let me introduce myself, my name is Andri Martiana, a doctoral student at the Institute of Islamic Banking and Finance (IIIiBF), International Islamic University Malaysia, Kuala Lumpur, Malaysia (IIUM). Currently, I am working on my doctoral thesis on the topic "Agency problem in Micro-business Financing at Baitul Maal wa Tamwil (BMT) in Indonesia." I will facilitate validation sessions from these experts/experts as one of the stages in preparing my doctoral thesis.

This theme is based on the researcher's enthusiasm for BMT, which is a Sharia microfinance institution in Indonesia with a dual role, namely commercial and social functions. Based on the existing literature review, BMT plays a role in empowering the people's economy, one of which is through financial services and providing access to financing for the poor. However, BMT faces many obstacles in carrying out its operations, including those related to the selection (screening) process for customers who will become partners, the implementation of credit-plus financing, and the problem of default among poor borrowers, one of which is caused by moral hazard actions. This research aims to explore agency problem, investigate the role of programs that have been carried out to deal with agency problem, and propose solutions to agency problem in micro-business financing at BMT in Indonesia.

Prior to the interview, you will be sent/given two Interview Consent forms (one to sign and return and one to keep) prior to today's session. This interview will take approximately 60 minutes maximum and will follow a designed interview protocol.

### Introductory Protocol

To make our note-taking easier, we want to record our conversation today using audio and video. For your information, only project researchers will be privy to the tapes which will ultimately be destroyed after being transcribed. Additionally, you must sign our Interview Consent form. Basically, this document states that:

- 1) All information will be kept confidential.
- 2) Your participation is voluntary, and you can stop at any time if you feel uncomfortable; And
- 3) We do not mean to hurt.

We have planned this interview to last no more than one hour with semi-structured interview questions. This means that the interview process will take place with several questions that have been designed but it is not an obligation to fulfill them according to the design. This is because interviews in qualitative research are very specific for each participant because they will explore their personal experiences. During that one hour, we will try to make the best use of the time available. For the record, in asking questions,

researchers will use phrases such as “Tell me more”, “Can you give me an example?”, “Can you explain that?” as a guide to request more detailed information if necessary.

Next, below we have some questions we want to cover.

Thank you for your agreement to participate.

**Research conducted by:**

Andri Martiana  
PhD Candidate,  
Institute of Islamic Banking and Finance IIUM (IIiBF),  
International Islamic University Malaysia,  
Gombak Road,  
53100 Selangor Darul Ehsan,  
Kuala Lumpur, Malaysia

**Supervisor:**

Professor Dr. Salina Kassim  
Institute of Islamic Banking and Finance IIUM (IIiBF),  
International Islamic University Malaysia,  
Gombak Road,  
53100 Selangor Darul Ehsan,  
Kuala Lumpur, Malaysia

Assoc. Prof. Dr. Habeebullah Zakariyah  
Institute of Islamic Banking and Finance IIUM (IIiBF),  
International Islamic University Malaysia,  
Gombak Road,  
53100 Selangor Darul Ehsan,  
Kuala Lumpur, Malaysia

## **Informant Demographic Information**

To start, let's introduce ourselves.

Name of informant/interviewee

(Full name with title):

Gender :

Institution :

Division :

Areas of expertise :

How long have you been in your current position?

Do you have any other work experience?

(e.g. as a practitioner/academic)?

Other background information from Participants:

### **A. Contract**

- What financing contracts/agreements are used by BMT to finance micro-businesses?
  - Of the several contracts that have been mentioned, which contract or agreement is most popular with both members (customers) and BMT? Why?
  - Of the several contracts that have been mentioned, which contracts/contracts are the most problematic (top three rankings)? Why?

### **B. Selection Process and Agency Problem in Micro-business Financing**

1. What is the selection or screening process for BMT micro-business financing partners?
2. Does BMT require guarantees/collateral in providing financing for micro-businesses? If yes, what is the form and mechanism for applying for the guarantee?
3. What is BMT's strategy for dealing with micro-business financing customers who do not have collateral? Is there a policy for applying social security to BMT? If so, how is it implemented?
4. Has there ever been agency problem such as dishonest behaviour from customers, allocation of financing funds not in accordance with the financing agreement, and/or manipulation of partner business results reporting in the contracts used in micro-business financing? If so, how did this happen?
5. From internal and external factors, which parties are involved/influenced in triggering agency problem in micro-business financing?
6. To what extent is the influence of the financing partner selection/screening process/mechanism implemented by BMT in minimising agency problem in micro-business financing?
7. What is the effect of obligations on guarantees (collateral) in minimising the occurrence of agency problem in financing?
8. What is the role of shared responsibility (social security) in minimising the occurrence of agency problem in micro-business financing?

### **C. Strategy and its impact**

1. What opportunities and strengths does BMT have in overcoming agency problem in micro-business financing?
2. What strategies/approaches or programs have been implemented by BMT in dealing with agency problem that occur in micro-business financing? What are

- the obstacles in implementing the strategy/approach/program? Has the strategy/approach/program been implemented optimally?
3. If viewed from an external party, what are the obstacles and challenges faced by BMT in implementing BMT's strategy/approach or programs in dealing with agency problem that occur in micro-business financing? How do customer partners respond to the program?
  4. What is the impact of the BMT program aimed at minimising the occurrence of agency problem in micro-business financing?
  5. What are real examples of the success of the BMT strategy in minimising agency problem in micro-business financing?
- D. Program on BMT
1. Does BMT supervise/monitor/mentor the business activities of financing partners?
    - If so, what is the supervision/monitoring/assistance mechanism?
    - What is the impact of supervision/monitoring/assistance in minimising the occurrence of agency problem in micro-business financing at BMT?
  2. Does BMT also have group lending and joint liability programs? If yes, what is the mechanism?
    - How do group loans and joint liability programs have an effect on minimising agency problem in micro-business financing?
    - To what extent can group lending and joint liability programs be a solution to agency problem that occur in micro-business financing at BMT?
  3. Does BMT also have a social development program? If so, what is the mechanism?
    - What are the advantages and/or differences between this social development program and programs at other Sharia microfinance institutions or conventional microfinance institutions?
    - How does the social development program influence minimising agency problem in micro-business financing?
    - To what extent can the social development program be a solution to the agency problem in micro-business financing in BMT?
  4. Does BMT utilize technology or digitalization systems to minimize agency problem in micro-business financing at BMT?
    - How do technology or digitalization systems influence minimising agency problem in micro-business financing?
    - To what extent can technology or digitalization systems minimize agency problem in micro-business financing at BMT?
  5. What are BMT's future strategic plans to overcome agency problem in micro-business financing?

**Closing question:**

Are there any suggestions/comments/anything else you would like to share with us?

Comments after interview and/or Observation:

## APPENDIX II

### RESEARCH INSTRUMENTS

#### INTERVIEW CONSENT FORM

Research title : "Agency Problem in Micro-business Financing at Baitul  
Maal wa Tamwil (BMT) in Indonesia"

Research interviewer :

Name of Research Informant :

Thank you for agreeing to be interviewed as part of the above research project. Ethical procedures for conducting academic research require that people be interviewed, explicitly agree to be interviewed and know how the information contained in their interview will be used. This consent form is necessary for us to ensure that you understand the purpose of your involvement and that you agree to the terms of your participation. Therefore, you will read the attached information sheet and then sign this form to acknowledge that you agree to the following:

- I understand that most interviewees will find the discussion interesting and thought-provoking. However, if I feel uncomfortable in any way during the interview session, I reserve the right to refuse to answer any questions or end the interview.
- Participants will be interviewed by the researcher and the interview will last approximately 45-60 minutes. Notes will be taken during the interview. An audio, video or photo recording of the interview and subsequent dialogue will be made.
- Interviews will be recorded, and transcripts will be produced.
- You will be sent a transcript and given the opportunity to correct factual errors.
- Interview transcripts will be analysed by (Andri Martiana) as the researcher in this study.
- Access to interview transcripts will be limited to (Andri Martiana) and academic colleagues and researchers with whom he may collaborate as part of the research process.
- Summaries of interview content, or direct quotes from interviews, made available through academic publications or other academic outlets will be anonymized so that you cannot be identified, and care will be taken to ensure that other information in the interview that could identify you is not disclosed.
- The actual recordings will be (saved and then destroyed once the transcription process is complete and research completion has been completed).

#### **Quotation agreement**

I also understand that my words may be quoted directly. Regarding quotations, please initial the statement you disagree with:

- I would like to review notes, transcripts, or other data collected during the research related to my participation.

- I agree to be quoted directly.
- I agree to be quoted directly if my name is not published and another name (pseudonym) is used.
- I agree that researchers should publish documents containing my quotations.
- All or part of your interview content can be used:
  - In academic papers, policy papers, or news articles.
  - On our website and in other media that we may produce such as in scientific presentations.
  - At other feedback events.
  - In the project archive as mentioned above.

By signing this form, I agree to that.

1. I voluntarily take part in this research activity. I understand that I do not have to take part, and I can stop the interview at any time.
2. Transcribed interviews or excerpts from them may be used as described above.
3. I have read the Information sheet.
4. I do not expect to receive any benefits or payment for my participation.
5. I may request a copy of my interview transcript and may edit it if I feel necessary to ensure effectiveness as well as confidentiality.
6. I can ask any questions I may have, and I understand that I am free to contact the researcher with any questions I may have in the future.

Participant Name:  
 Researcher Name:  
 Place :  
 Date :

Signature of approval,  
 .....  
 (.....)

For further information, please contact:  
 Andri Martiana  
 Phone Number. +6281234264362

## INTERVIEW PROTOCOL

Organization & Location:

Date/time:

Participant Name:

Researchers conduct sessions:

Let me introduce myself, my name is Andri Martiana, a doctoral student at the Institute of Islamic Banking and Finance (IIIiBF), International Islamic University Malaysia, Kuala Lumpur, Malaysia (IIUM). Currently, I am working on my doctoral thesis on the topic "Agency problem in Micro-business Financing at Baitul Maal wa Tamwil (BMT) in Indonesia." I will facilitate interview sessions with the participants of this research as one of the stages in preparing my doctoral thesis.

This theme is based on the researcher's enthusiasm for BMT, which is a Sharia microfinance institution in Indonesia with a dual role, namely commercial and social functions. Based on the existing literature review, BMT plays a role in empowering the people's economy, one of which is through financial services and providing access to financing for the poor. However, BMT faces many obstacles in carrying out its operations, including those related to the selection (screening) process for candidates/members who will become partners, the implementation of credit-plus financing, and the problem of default among poor borrowers, one of which is caused by moral hazard actions. This research aims to explore depth agency problem, investigate the implementation of programs to overcome agency problem, and propose strategies as solutions to agency problem in financing BMT micro-businesses in Indonesia.

Prior to the interview, you will be sent/given two Interview Consent forms (one to sign and return and one to keep) prior to today's session. This interview will take approximately 40-90 minutes and will follow a designed interview protocol.

### **Introductory Protocol**

To make our note-taking easier, we want to record our conversation today using audio and video. For your information, only project researchers will be privy to the tapes which will ultimately be destroyed after being transcribed. Additionally, you must sign our Interview Consent form. Basically, this document states that:

- 1) All information will be kept confidential.
- 2) Your participation is voluntary, and you can stop at any time if you feel uncomfortable; And
- 3) We don't mean to hurt.

We have planned this interview to last no more than one hour with semi-structured interview questions. This means that the interview process will take place with several questions that have been designed but it is not an obligation to fulfill them according to the design. This is because interviews in qualitative research are very specific for each participant because they will explore their personal experiences. During that one hour, we will try to make the best use of the time available. For the record, in asking questions, researchers will use phrases such as "Tell me more", "Can you give me an example?", "Can you explain that?" as a guide to request more detailed information if necessary.

Next, below we have some questions we want to cover.

Thank you for your agreement to participate.

Research conducted by:

**Research conducted by:**

Andri Martiana  
PhD Candidate,  
Institute of Islamic Banking and Finance IIUM (IIiBF),  
International Islamic University Malaysia,  
Gombak Road,  
53100 Selangor Darul Ehsan,  
Kuala Lumpur, Malaysia

**Supervisor:**

Professor Dr. Salina Kassim  
Institute of Islamic Banking and Finance IIUM (IIiBF),  
International Islamic University Malaysia,  
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Institute of Islamic Banking and Finance IIUM (IIiBF),  
International Islamic University Malaysia,  
Gombak Road,  
53100 Selangor Darul Ehsan,  
Kuala Lumpur, Malaysia

**Informant Demographic Information**

To start, let's introduce ourselves.

Name of informant/interviewee  
(Full name with title):

Gender :

Institution :

Division :

Areas of expertise :

How long have you been in your current position?

Do you have any other work experience?

(e.g. as a practitioner/academic)?

Other background information from Participants:

**A. Agency problem and challenges in financing BMT micro-businesses in Indonesia**

1. Have agency problem occurred, such as dishonest behaviour from customers, allocation of financing funds that are not in accordance with the financing agreement, and/or manipulation of partner business results reporting in contracts used in micro-business financing? If so, how did that happen?

*Select accompanying questions, as appropriate:*

- *What financing contracts do BMT use to finance micro-businesses?*
- *Of the several contracts mentioned, which contract is most popular with members (customers) and BMT? Why?*
- *Of the several contracts that have been mentioned, which contract/contracts are the most problematic (ranked in the top three)? Why?*
- *What is the selection or screening process for BMT micro-business financing partners?*
- *Does BMT require collateral/guarantees to provide financing for micro-businesses? If yes, what is the form and mechanism for applying collateral?*

**B. Factors causing agency problem in financing BMT micro-businesses in Indonesia**

2. From internal and external factors, what factors influence the triggers of agency problem in micro-business financing at BMT?

*Select accompanying questions, as appropriate:*

- *Why can these factors trigger agency problem?*
- *How do you think these factors can trigger agency problem?*
- *Which parties are involved in the factors that trigger agency problem?*

**C. BMT program in overcoming agency problem in financing BMT micro-businesses in Indonesia**

3. What programs has BMT implemented to handle agency problem that occur in micro-business financing? What are the obstacles to implementing the program? Has the program been implemented optimally?

*Select accompanying questions, as appropriate:*

- *To what extent is the influence of the financing partner selection/screening process/mechanism carried out by BMT in minimising agency problem in micro-business financing?*
- *What is the influence of obligations on collateral (collateral) in minimising the occurrence of agency problem in financing?*
- *What is the role of shared responsibility (social security) in minimising agency problem in microenterprise financing?*
- *What is the impact of the BMT program aimed at minimising agency problem in micro-business financing?*
- *What are real examples of the success of the BMT strategy in minimising agency problem in micro-business financing?*

- *Does BMT supervise/monitor/mentor the business activities of financing partners?*
- *If yes, what is the monitoring/monitoring/assistance mechanism?*
- *What is the impact of supervision/monitoring/assistance in minimising the occurrence of agency problem in micro-business financing at BMT?*
- *Does BMT also have group loan and joint liability programs? If yes, what is the mechanism?*
- *What is the influence of group loan programs and joint obligations in minimising agency problem in micro-business financing?*
- *To what extent can group lending and joint liability programs be a solution to agency problem that occur in micro-business financing at BMT?*
- *Does BMT also have a program for providing incentives, discounts or bonuses in micro-business financing? If yes, what is the mechanism? How do partners respond to the program?*
- *What is the effect of programs providing incentives, discounts or bonuses in micro-business financing in minimising agency problem in micro-business financing?*
- *Does BMT also have a social development program? if so, what is the mechanism?*
- *What are the advantages and/or differences between this social development program and other Sharia microfinance institutions or conventional microfinance institutions?*
- *How do social development programs influence the occurrence of agency problem in microenterprise financing?*
- *To what extent can the social development program be a solution to the agency problem of micro-business financing in BMT?*
- *Does BMT utilize technology or digitalization systems to minimize agency problem in micro-business financing at BMT?*
- *What is the influence of technology or digitalization systems in minimising agency problem in micro-business financing?*
- *To what extent can technology or digitalization systems minimize agency problem in micro-business financing at BMT?*

**D. Strategic planning for overcoming agency problem in financing BMT micro-businesses in Indonesia**

4. What is BMT's strategic plan for dealing with agency problem in micro-business financing at BMT? Can this strategy be implemented optimally?

*Select accompanying questions, as appropriate:*

- *What are the opportunities and strengths of BMT in overcoming agency problem in micro-business financing?*
- *What obstacles and challenges does BMT face in overcoming agency problem in micro-business financing?*
- *What are BMT's future strategic plans to overcome agency problem in micro-business financing?*

**Closing question:**

1. Do you have any suggestions/comments/anything else you'd like to share with us?
2. Comments after interview and/or Observation:

## RESEARCH SURVEY

Dear Participants,

Let me introduce myself, my name is Andri Martiana, a doctoral student at the Institute of Islamic Banking and Finance (IIBF), International Islamic University Malaysia, Kuala Lumpur, Malaysia (IIUM). Currently, I am working on my doctoral thesis on the topic "Agency Problem in Micro-business Financing at Baitul Maal wa Tamwil (BMT) in Indonesia." I will facilitate survey sessions from the participants of this research as one of the stages in preparing my doctoral thesis.

This theme is based on the researcher's enthusiasm for BMT, which is a Sharia microfinance institution in Indonesia with a dual role, namely commercial and social functions. Based on the existing literature review, BMT plays a role in empowering the people's economy, one of which is through financial services and providing access to financing for the poor. However, BMT faces many obstacles in carrying out its operations, including those related to the selection (screening) process for customers who will become partners, the implementation of credit-plus financing, and the problem of default among poor borrowers, one of which is caused by moral hazard actions. This research aims to explore depth agency problem, investigate the implementation of programs to overcome the agency problem, and propose strategies as solutions to the agency problem in financing BMT micro-businesses in Indonesia.

To make it easier to complete, in answering this survey question, you will be presented with a brief explanation of the related material (attached material). There are two types of questions in this survey, the first is multiple choice questions which can be filled in or choose more than one answer option and also fill-in questions which contain comments related to the problems discussed in the research. Filling out this survey takes a maximum of 15 minutes.

All answers provided will be kept confidential and only used for research purposes. Your kind cooperation in answering these survey questions is greatly appreciated.

Next, below we have some questions we want to cover.

Thank you for your agreement to participate.

**Research conducted by:**

Andri Martiana  
PhD Candidate,  
Institute of Islamic Banking and Finance IIUM (IIBF),  
International Islamic University Malaysia,  
Gombak Road,  
53100 Selangor Darul Ehsan,  
Kuala Lumpur, Malaysia

**Supervisor:**

Professor Dr. Salina Kassim  
Institute of Islamic Banking and Finance IIUM (IIBF),  
International Islamic University Malaysia,

Gombak Road,  
53100 Selangor Darul Ehsan,  
Kuala Lumpur, Malaysia

Assoc. Prof. Dr. Habeebullah Zakariyah  
Institute of Islamic Banking and Finance IIUM (II/IF),  
International Islamic University Malaysia,  
Gombak Road,  
53100 Selangor Darul Ehsan,  
Kuala Lumpur, Malaysia

### **Informant Demographic Information**

To start, let's introduce ourselves.

Name of informant/interviewee

(Full name with title):

Gender :

Institution :

Division :

Areas of expertise :

How long have you been in your current position?

Do you have any other work experience?

(e.g. as a practitioner/academic)?

Other background information from Participants:

**Please fill in by marking (x) or (O) on the answer choices (there can be more than one answer choice) and fill in the questions according to your experience or knowledge!**

<p>1. The following is a contract/financing agreement used by BMT to finance micro businesses (more than one answer is allowed):</p> <ol style="list-style-type: none"> <li>Murabaha</li> <li>Musharakah</li> <li>Mudarabah</li> <li>Ijarah</li> <li>Qardhul Hasan</li> <li>Others, please specify .....</li> </ol> <p>.....</p> <p>.....</p> <p>2. The following are the most popular financing contracts/agreements in micro business financing (more than one answer is allowed):</p> <ol style="list-style-type: none"> <li>Murabahah</li> <li>Musharakah</li> <li>Mudarabah</li> <li>Ijarah</li> <li>Qardhul hasan</li> <li>Others, please specify .....</li> </ol> <p>.....</p> <p>.....</p> <p>3. Why is this contract/agreement most popular in micro business financing?</p> <p>.....</p> <p>.....</p> <p>.....</p>	<p>4. The following are the financing contracts/agreements that are most NOT popular in micro business financing (more than one answer is allowed):</p> <ol style="list-style-type: none"> <li>Murabahah</li> <li>Musharakah</li> <li>Mudarabah</li> <li>Ijarah</li> <li>Qardhul hasan</li> <li>Others, please specify .....</li> </ol> <p>.....</p> <p>.....</p> <p>5. Why is this contract/agreement the least popular in micro business financing?</p> <p>.....</p> <p>.....</p> <p>6. The following is part of the requirements for the micro business financing partner selection process at BMT (more than one answer is allowed):</p> <ol style="list-style-type: none"> <li>Guarantee/collateral</li> <li>Shared responsibility (social security)</li> <li>History / track record of financing partners</li> <li>Others, please specify .....</li> </ol> <p>.....</p> <p>.....</p>
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<p>7. Forms of agency problems that occur in micro business financing (more than one answer is allowed):</p> <ol style="list-style-type: none"> <li>Errors in selecting financing partners.</li> <li>Misuse of allocation of financing funds</li> <li>Dishonesty in reporting business results</li> <li>Others, please specify .....</li> </ol> <p>.....</p> <p>.....</p> <p>8. Factors causing agency problems are (more than one answer is allowed):</p> <ol style="list-style-type: none"> <li>Type of contract/contract</li> <li>Selection process</li> <li>Presence/absence of guarantees</li> <li>BMT HR</li> <li>Lack of supervision</li> <li>Partner's dishonest behavior</li> <li>Others, please specify .....</li> </ol> <p>.....</p> <p>.....</p> <p>9. Programs that can minimize agency problems are (more than one answer allowed):</p> <ol style="list-style-type: none"> <li>Warranty obligations</li> <li>Social security (shared responsibility / social collateral)</li> <li>Optimization of surveillance systems</li> <li>Social coaching</li> <li>Utilization of technology or digitalization of systems</li> <li>Incentives Giving</li> <li>Others, please specify .....</li> </ol> <p>.....</p> <p>.....</p>	<p>10. BMT's strategic plan that can be a solution to agency problems in micro business financing at BMT is (more than one answer is allowed):</p> <ol style="list-style-type: none"> <li>Implementation of the contract according to sharia principles.</li> <li>Optimizing the customer selection process.</li> <li>Special SOP for micro business financing.</li> <li>Optimizing coaching programs for members.</li> <li>Optimizing the supervisory function of financing partners.</li> <li>Collaboration with other institutions.</li> <li>Increasing financial and sharia business literacy for BMT members.</li> <li>Others, please specify .....</li> </ol> <p>.....</p> <p>.....</p> <p>11. Are there any suggestions/comments/anything else you would like to share with us?</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p> <p>.....</p>
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**Thank you very much for your participation in filling out this research survey.**

**EXPERT CONTENT VALIDATION SURVEY FORM**

**CODING VALIDITY APPROVAL FORM**

Research title : "Agency Problem in Micro-business Financing at Baitul Maal wa Tamwil (BMT) in Indonesia"

Academic Name :

Areas of expertise :

Thank you for agreeing to conduct validity coding as part of the above research project. Ethical procedures for conducting academic research require that the people participating explicitly agree to be part of it and know how the information contained in their explanations will be used. This consent form is necessary for us to ensure that you understand the purpose of your involvement and that you agree to the terms of your participation.

By signing this form, I agree that:

1. I voluntarily take part in this research activity.
2. Transcribed comments, criticisms and suggestions or excerpts from them may be used in the research.
3. I have read the Information sheet.
4. I do not expect to receive any benefits or payment for my participation.
5. I can request a copy of my validation results and can edit them if I feel necessary to ensure effectiveness and confidentiality.
6. I can ask any questions I may have, and I understand that I am free to contact the researcher with any questions I may have in the future.

Participant Name :

Place :

Date :

Signature of approval,  
....., .....

(.....)

For further information, please contact:

Andri Martiana

Phone. +6281234264362

## **CODING CATEGORY VALIDITY FROM EXPERTS**

Dear expert,

My name is Andri Martiana, a doctoral student at the International Islamic University Malaysia (IIUM) Institute of Islamic Banking and Finance (IIiBF), International Islamic University Malaysia, Kuala Lumpur, Malaysia. My research entitled “Agency Problem in Microenterprise Financing of *Baitul Maal wa Tamwil* (BMT) in Indonesia.” This research attempts to explore the agency problem, investigate the role of programs for dealing with agency problem that has been carried out, and propose solutions to agency problem in microenterprise financing of BMT in Indonesia.

All answers provided will be treated with strict confidentiality and used for research purposes only.

Your kind cooperation in answering these interview questions is highly appreciated.

Thank You

Conducted by:

Andri Martiana  
PhD candidate,  
IUM Institute of Islamic Banking and Finance (IIiBF),  
International Islamic University Malaysia,  
Jalan Gombak,  
53100 Selangor Darul Ehsan,  
Kuala Lumpur, Malaysia

Supervisor:

Professor Dr. Salina Kassim  
IUM Institute of Islamic Banking and Finance (IIiBF),  
International Islamic University Malaysia,  
Jalan Gombak,  
53100 Selangor Darul Ehsan,  
Kuala Lumpur, Malaysia

### Section A: Participant's demographic information

Please Input your name:

Please Input your initial name:

Please Input the Name of Organization(s) You Are Affiliated With:

Please Specify Your Gender:

Male

Female

Other

Please Specify your area of expertise:

Economics

Finance

Accounting

Islamic Economics

Islamic Finance

Islamic Accounting

Other,

Please specify: \_\_\_\_\_

Please Specify Your Experience of Academics/Lecturer/Researcher/Practitioner:

0 to 5 years

6 to 10 years

11 to 15 years

16-20 years

More than 20 years

Please Specify the Nature of Your Experience:

Academics

Lecturer

Researcher

Practitioner

Other,

Please specify: \_\_\_\_\_

### Section B: Coding Category

#### Entire Survey

Entire Survey Critique: Please answer the questions with specific examples (if applicable) concerning the entire survey instrument.

I. Would you suggest any changes to the category or sub-category?

II. Do the survey items provide content validity? Content validity is whether the items on the instrument sufficiently model the targeted content area (Gable and Wolf, 1993, p. 96).

III. Does the wording provide a clear and concise understanding of each category or sub-category item?

IV. Are the sub-category items sufficient for explaining each category? Why or why not?

V. Any Additional Comments:

Category	Subcategory	Would you suggest any changes in the wording to increase understanding? Please provide any specific feedback.	Is this item applicable & sufficient to explain or represent the category
Agency Problem	Adverse selection		
	Members do not disclose information		
	Dishonesty		
	Misuse of fund allocation		
	Report manipulation		
	The character is not good		
	Payment failure		
	Inability to pay in instalments		
Causes of Agency problem	Able to pay but the desire to pay is difficult		
	Type of contract		
	Selection process		
	BMT HR		
	Afraid of not being accepted		
	Violating the SOP		
	Urgent needs		
	Whether or not there is a guarantee		
	System weaknesses		
	Risk management is starting to loosen up		
	Communication is not smooth to members		
	Character is not good		
	Lack of supervision		
	Capacity is not enough		
	Economic problems		
	Family conflict		
	Education is done with small talk		
	The implementation of the contract is not in accordance with Sharia		
Program to Minimize Agency Problem	There was intention at the start		
	There is still room for evil		
	Communication is not smooth with members		
	Increasing the capacity of BMT HR		
	Synergy and cooperation		
Program to Minimize Agency Problem	Development, Mentoring, and Training of BMT Members		
	Improvement of institution governance		
	Program innovation		

	The use of Information Technology		
Strategic Planning to Minimize Agency Problem	Capacity development of institution Human Resource		
	System digitization		
	Governance		
	Community education		
	Synergy and cooperation		
	Regulation		
	Specific models or methods		
	Member education		
	Supervision		

**Thank you so much for your time and participation!**



# APPENDIX III

## NVIVO PROJECT SUMMARY REPORT

1/5/2024 8:37 AM

### Project Summary Koding 1 Data Thesis 1/5/2024 8:37 AM

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<b>Last Modified</b>			<b>10/12/2023 4:18 PM</b>		
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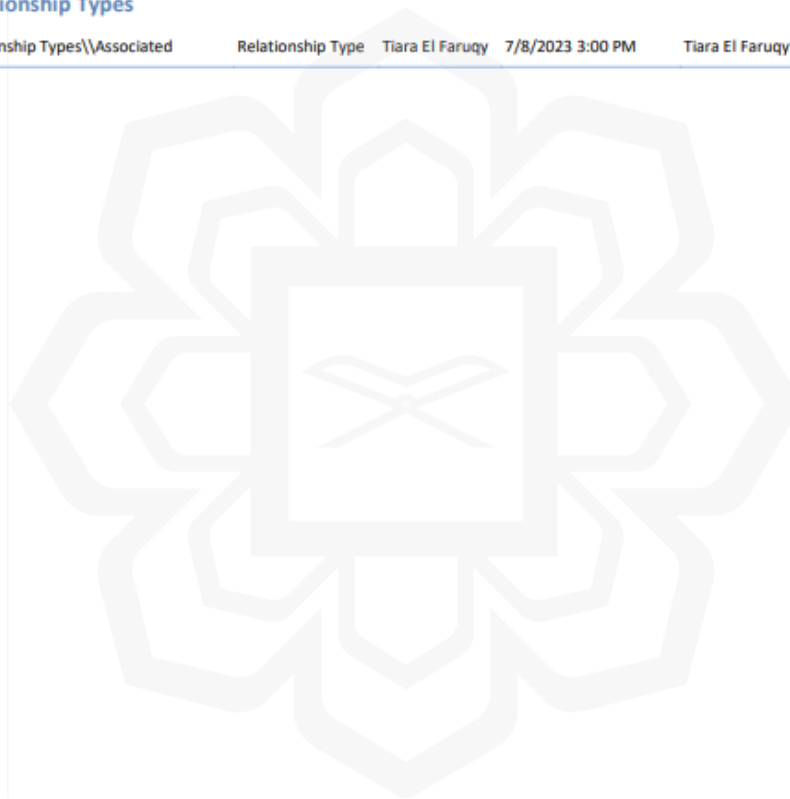
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APPENDIX IV

EXPERT VALIDATION TABULATION DATA

Expert Validation Tabulation Data (in Bahasa Indonesia)

Review Hasil Survei Validasi Ahli									Identifikasi Hasil Survei	Revisi Item Pertanyaan (d disesuaikan dengan saran dan masukan dari hasil survei)
Topik: Agency Problem in Micro-enterprise Financing of Baitul Maal wa Tamwil (BMT) in Indonesia										
Item Pertanyaan	Uraian survei	Experts								
		Expert 1	Expert 2	Expert 3	Expert 4	Expert 5	Expert 6	Expert 7		
<b>Item 1: Kontrak seperti apa yang digunakan BMT untuk membiayai usaha mikro?</b>  V: 6 IV: 1	Item pertanyaan Valid/ Tidak valid	Valid	Valid	Valid	Tidak Valid	Valid	Valid	Valid	V: 6 IV: 1	Akad pembiayaan apa sajakah yang digunakan oleh BMT untuk membiayai usaha mikro? Mengapa?
	Redaksional Item pertanyaan	Ok	Pertanyaan cukup baik dan sesuai dengan tujuan penelitian	kontrak / akad	Apa-apa saja yg kontrak digunakan BMT....	akad pembiayaan apa sajakah yang digunakan oleh BMT untuk membiayai usaha mikro?	Pertanyaan tersebut untuk melihat bentuk kontrak kerjasama antara BMT sebagai penyalur pembiayaan dan nasabah sebagai penerima pembiayaan. Sebaiknya ada pertanyaan yang langsung mengenai bentuk kerjasama antara BMT dan agen atau pertanyaan kontrak apa saja yang dimiliki/digunakan oleh BMT baik untuk nasabah atau pihak lainnya.	Di beri pilihan, Mudharabah, murabahah bil wakalah, musyawarah atau IMBT		

	Konten Item Pertanyaan	Ini what question, jika mengeksplorasi sebaiknya how or why questions. Ini sebagai pertanyaan pembuka untuk mengeksplorasi pd tahap selanjutnya.	Sudah tepat, akan tetapi secara redaksional harap menyesuaikan dengan kemampuan informan dalam menjawab pertanyaan	Sesuai	Ya Karena melihat keagenan dilihat Dari kontrak	sudah tepat. Pertanyaan sudah sesuai dengan tujuan penelitian. Sebab harus mengetahui akad2 pembiayaan yang digunakan untuk mempermudah penulis dalam analisis	Pertanyaan tersebut kurang tepat karena difokuskan untuk mengeksplorasi kerjasama BMT sebagai penyalur pembiayaan dengan nasabah sebagai penerima pembiayaan, sehingga belum mencerminkan secara langsung bentuk kerjasama antara BMT dengan agen.	Ya	Pertanyaan dapat digunakan sebagai pertanyaan pembuka untuk mengeksplorasi pada tahap selanjutnya.	
Item 2: Dari sekian banyak kontrak yang telah disebutkan, kontrak apa yang paling tidak diminati (oleh mitra nasabah maupun pihak BMT) dan paling bermasalah? Mengapa?  V: 6 IV: 1	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Tidak Valid	Valid	Valid	Valid	V: 6 IV: 1	Dari beberapa akad yang telah disebutkan, produk atau akad manakah yang kurang diminati baik oleh anggota (nasabah) maupun pihak BMT? Akad manakah yang paling bermasalah? Mengapa?
	Redaksional Item pertanyaan	Mungkin jika bisa diminta dirangking jdi nanti bisa dilihat preferensinya. Bisa fokus pada tiga teratas misalnya untuk menjawab why nya	Tidak ada	cukup jelas dan mudah difahami	Terlalu bnyk pertanyaan. Tdk diminati, Dan bermasalah. Keduanya bisa berbeda.	Dari bbrp akad yang telah disebutkan, produk atau akad manakah yang kurang diminati baik oleh anggota (nasabah) maupun pihak BMT? Akad manakah yang paling bermasalah? Mengapa?	Pertanyaan sebelumnya belum mencerminkan pertanyaan kontrak apa saja yang dimiliki/digunakan oleh BMT	Mudharabah		
	Konten Item Pertanyaan	Ya bisa , dari penjelasan definisi kontrak serta preferensi masyarakat dpt memberikan gbran potensi keagenan dan mungkin ada kasus terkait kontrak yg ada slama ini.	Pernyataan di atas sudah baik	tepat dan sesuai	Ya sesuai, hanya saja perlu pendalaman masing2 agar fokus Dan tidak bias	Sudah sesuai. Sebab keterangan yang diperoleh dari pertanyaan ini akan menjadi bahasan inti dalam judul penelitian ini	Pertanyaan tersebut masih relevan untuk mengeksplorasi menganalisis lebih dalam kontrak apa saja yang dimiliki oleh BMT	UMKM kebanyakan tidak punya pembukuan	Pertanyaan masih relevan untuk memberikan gambaran potensi masalah keagenan melalui identifikasi masalah pada akad/kontrak yang dipakai.	

<p>Item 3: Apa saja masalah keagenan yang pernah dan/sering terjadi dalam kontrak yang digunakan dalam pembiayaan usaha mikro? Bagaimana masalah keagenan ini bisa terjadi?</p> <p>V: 7</p>	<p>Item pertanyaan Valid/Invalid</p>	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	<p>Apakah pernah terjadi masalah keagenan seperti perilaku ketidakjujuran dari nasabah, alokasi dana pembiayaan tidak sesuai dengan akad pembiayaan, dan / atau manipulasi pelaporan hasil usaha mitra dalam akad (kontrak) yang digunakan dalam pembiayaan usaha mikro? Jika pernah, bagaimana hal tersebut terjadi?</p>
	<p>Redaksional Item pertanyaan</p>	<p>Utk point ini, sebaiknya beri cth ttg masalah keagenan yg paling dekat dgn kegiatan BMT. Krn, sayang jika responden tidak memahami definisi masalah keagenan, jawaban yg diberikan nanti kurang tepat.</p>	<p>Perlu dijelaskan kepada pihak BMT apa maksud dari teori keagenan</p>	<p>bagus</p>	<p>Sudah baik, pertanyaan kedua mendalami pertanyaan pertama</p>	<p>Apakah pernah terjadi masalah keagenan dalam akad (kontrak) yang digunakan dalam pembiayaan usaha mikro? Jika pernah, bagaimana hal tersebut terjadi?</p>	<p>Tidak ada</p>	<p>Tidak ada saran</p>		
	<p>Konten Item Pertanyaan</p>	<p>Cth yg diberikan bersifat general saja, atau mungkin memberikan kalimat asositatif yang umumnya terhubung dgn masalah keagenan. Dengan begitu, insya Allah ekspolari yg diharapkan bisa terjawab</p>	<p>Tepat, akan tetapi dijelaskan terlebih dahulu apa itu teori keagenan, karena tdk semua praktisi mempunyai latar belakang penguasaan teori yang baik</p>	<p>ya</p>	<p>Ya sdh sesuai. Untuk mengeksplor permasalahan keagenan</p>	<p>Sudah sesuai. Jawaban dari pertanyaan akan menjadi bahan (data) dalam pembahasan pada penelitian ini.</p>	<p>Pertanyaan masih relevan untuk menggali permasalahan mengenai keagenan</p>	<p>Ya sesuai</p>	<p>Perlu diberikan penjelasan melalui contoh umum untuk dapat mengeksplorasi lebih dalam terkait masalah keagenan</p>	
<p>Item 4: Apa saja tantangan yang dihadapi dalam hubungan keagenan yang pernah dan/sering terjadi pada kontrak yang digunakan untuk membiayai usaha mikro tersebut?</p> <p>V: 6 IV: 1</p>	<p>Item pertanyaan Valid/Invalid</p>	Valid	Valid	Valid	Tidak Valid	Valid	Valid	Valid	V: 6 IV: 1	<p>Tantangan apa sajakah yang dihadapi kaitannya dalam hubungan keagenan yang pernah dan/sering terjadi pada akad (kontrak) pembiayaan yg digunakan dalam pembiayaan usaha mikro tersebut?</p>
	<p>Redaksional Item pertanyaan</p>	<p>Item ini sama dengan point sebelumnya, utk menanyakan hal ini lebih baik memberikan kata asositatif yg familiar ttg masalah hubungan keagenan di BMT. Atau melalui contoh,</p>	<p>Pertanyaan jelas</p>	<p>cukup jelas</p>	<p>Mirip sekali dengan pertanyaan sebelumnya</p>	<p>Tantangan apa sajakah yang dihadapi kaitannya dalam hubungan keagenan yang pernah dan/sering terjadi pada akad (kontrak) pembiayaan yg digunakan dalam pembiayaan usaha mikro tersebut?</p>	<p>Tidak ada</p>	<p>Penjelasan ttg isi akad blm di ketahui nasabah</p>		

		untuk mendptkan jaeaban lbih tepat dari responden.								
	Konten Item Pertanyaan	Ini akan mengeksplorasi kendala yg ada di lapangan	Pertanyaan jelas	Cukup	Pengulangan Dari pertanyaan sebelumnya	Sudah tepat. Sudah sesuai dengan tujuan penelitian.	Pertanyaan masih relevan untuk menggali informasi mengenai tantangan kerjasama dengan agen	Ya	Pertanyaan jelas dan relevan akan tetapi perlu dicek Kembali apakah item pertanyaan dapat digabung dengan item pertanyaan 3.	
Item 5: Apa saja isu dan tantangan terkait dengan masalah informasi asimetris, <i>adverse selection</i> dan <i>moral hazard</i> pada pembiayaan usaha mikro di BMT? Bagaimana masalah ini bisa terjadi?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Kaitannya dengan masalah seperti Informasi Asimetris, adverse selection dan moral hazard. Apakah pernah terjadi dalam proses pembiayaan usaha mikro di BMT? Bagaimana hal tersebut bisa terjadi?
	Redaksional Item pertanyaan	Point sama, utk kalimat yg akademis seperti informasi asymetris, adverse selection, dan moral hazard sebaiknya konteks dibuat lebih familiar . Jika memang dibutuhkan, bisa ditanyakan terpisah kalau memang potensi keagenan yg terjadi bisa case by case dan varoatif.	Perlu diperjelas sebelumnya kepada pihak BMT terkait teori di atas	Ok	Walaupun mirip, sebaiknya dipisah pertanyaan untuk konsep2 tersebut	Kaitannya dengan masalah seperti Informasi Asimetris, adverse selection dan moral hazard. Apakah pernah terjadi dalam proses pembiayaan usaha mikro di BMT? Bagaimana hal tersebut bisa terjadi?	Tidak ada	Tidak ada saran		

	Konten Item Pertanyaan	Menyesuaikan konteks secara teori , jika perlu dipertanyakan terpisah utk 3 hal tadi dgn mempelajari potensi masalah keagenan yg bisa terjadi di BMT.	Perlu diperjelas sebelumnya kepada pihak BMT terkait teori di atas	Sesuai	Ya sudah sesuai	Sudah sesuai. Sudah sesuai dengan tujuan penelitian. Jawaban atas pertanyaan ini akan menjadi jawaban dari tujuan penelitian.	Apabila saya tidak salah memaknai pertanyaan ini yang merupakan pertanyaan secara umum, maka perlu ditempatkan di awal. Pertanyaan tersebut relevan untuk menggali lebih dalam permasalahan secara umum penyaluran pembiayaan usaha mikro.	Sudah sesuai	Konten item pertanyaan relevan dengan tujuan penelitian, meskipun demikian perlu dipertimbangkan bagaimana agar partisipan dapat lebih mudah memahami ketiga masalah yang ditanyakan pada item pertanyaan tersebut.	
Item 6: Pihak-pihak apa saja yang berpengaruh dalam memicu terjadinya masalah keagenan pada pembiayaan usaha mikro?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	V	V: 7	Pihak mana sajakah yang terlibat / berpengaruh dalam memicu terjadinya masalah keagenan pada pembiayaan usaha mikro?
	Redaksional Item pertanyaan	Kalimatnya type negatif, subjek lebih jujur jika pertanyaan bersifat positif.	Pertanyaan cukup jelas	pihak pihak mana saja dong	Siapa saja pihak2 yg berpengaruh..	Pihak mana sajakah yang berpengaruh dalam memicu terjadinya masalah keagenan pada pembiayaan usaha mikro?	Tidak ada	Tidak ada saran		
	Konten Item Pertanyaan	Ya bisa	Pertanyaan cukup jelas	ok	Ya sdh	Sudah sesuai dengan tujuan penelitian	Pertanyaan tersebut relevan, namun sebagai masukan perlu ada pertanyaan awal untuk mengetahui pihak-pihak yang terlibat dalam pembiayaan usaha mikro	Sudah sesuai	Pertanyaan cukup jelas dan relevan dengan tujuan penelitian.	
Item 7: Bagaimana strategi/ pendekatan/program BMT dalam menghadapi masalah keagenan yang terjadi pada pembiayaan usaha mikro? Apakah semua strategi dan/ program ini telah dilaksanakan?	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Strategi/ pendekatan atau program-program apa saja yang telah dilakukan oleh BMT dalam menghadapi masalah keagenan yang terjadi pada pembiayaan usaha mikro? Apa saja kendala dalam pelaksanaan

V: 7	Redaksional Item pertanyaan	Setelah how mungkin bisa diekslore apa kendala dlm pengaplikasian strategi dan follow up yg dilakukan selama ini, apakah semua termonitor dgn baik. Tya btuk nya spti apa.	Pertanyaan cukup jelas	ok	Tdk ada	Strategi/ pendekatan atau program-program apa saja yang telah dilakukan oleh BMT dalam menghadapi masalah keagenan yang terjadi pada pembiyaan usaha mikro?	Tidak ada	Di sebutkan Program nya yang spesifik	Setelah pertanyaan mengenai "bagaimana" bisa diekslore lebih lanjut terkait apa kendala dalam pelaksanaan strategi serta apakah pelaksanaan strategi tersebut telah termonitor dengan baik ataau belum.	strategi/pendekatan/program tersebut?
	Konten Item Pertanyaan	Bisa, dgn mengetahui track record solutif yg dilakukan selama ini oleh BMT utk mengatasi masalah keagenan yg ditemui.	Pertanyaan cukup jelas	tepat	Sdh sesuai	Sudah sesuai dengan tujuan penelitian.	Pertanyaan tersebut relevan	Sudah sesuai	Konten pertanyaan bisa dimasukkan terkait track record solutif yang dilakukan oleh BMT selama ini untuk mengatasi masalah keagenan.	
Item 8: Apa kendala dan tantangan yang dihadapi BMT dalam melaksanakan program-program tersebut? Bagaimana tanggapan mitra nasabah terhadap program tersebut?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Jika ditinjau dari pihak eksternal, apa saja kendala dan tantangan yang dihadapi BMT dalam melaksanakan strategi/ pendekatan atau program-program BMT dalam menghadapi masalah keagenan yang terjadi pada pembiayaan usaha mikro? Bagaimana tanggapan mitra nasabah terhadap program tersebut?
	Redaksional Item pertanyaan	Ini bisa eksplere ke kendala yg fokus dari pihak eksternal.	Pertanyaan cukup jelas	good	Tdk ada	redaksi sudah tepat	Tidak ada	Tidak ada saran	Redaksi pertanyaan dapat difokuskan pada kendala dari pihak eksternal.	
	Konten Item Pertanyaan	Ya bisa, mengeksplere stakeholders' expectations	Pertanyaan cukup jelas	Cukup jelas	Sdh sesuai	Sudah sesuai dengan tujuan penelitian	Pertanyaan tersebut relevan	Sesuai	Konten pertanyaan sudah sesuai dengan tujuan penelitian.	
Item 9: Apa kekuatan yang dimiliki BMT dalam mengatasi masalah keagenan pada pembiayaan usaha mikro?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Apa kekuatan yang dimiliki BMT dalam mengatasi masalah keagenan pada pembiayaan usaha mikro?
	Redaksional Item pertanyaan	Ok	Pertanyaan cukup jelas	berarti ini analysis SWOT ya	...Yg dimiliki BMT anda...	sudah tepat	Tidak ada	Tidak ada masukan, yang pasti BMT selalu memberikan akad yang lebih menguntungkan pihak BMT	Redaksi pertanyaan sudah tepat.	
	Konten Item Pertanyaan	Ok	Pertanyaan cukup jelas	ok	Ya sdh	sudah sesuai dengan tujuan penelitian	Pertanyaan tersebut relevan	Sesuai	Pertanyaan cukup jelas dan sudah sesuai dengan tujuan penelitian.	

<p>Item 10: Peluang apa yang dimiliki BMT dalam mengatasi masalah keagenan pada pembiayaan usaha mikro?</p> <p>V: 6 IV: 1</p>	<p>Item pertanyaan Valid/Invalid</p>	<p>Valid</p>	<p>Valid</p>	<p>Valid</p>	<p>Tidak Valid</p>	<p>Valid</p>	<p>Valid</p>	<p>Valid</p>	<p>V: 6 IV: 1</p>	<p>Peluang apa yang dimiliki BMT dalam mengatasi masalah keagenan pada pembiayaan usaha mikro?</p>
	<p>Redaksional Item pertanyaan</p>	<p>Bisa jadi lebih baik jika dpt mencari kalimat "masalah keagenan" dgn kata yg lebih mudah difahami atau diasosiasikan bagi responden.</p>	<p>Masih tumpang tindih antara satu kata dengan kata lainnya</p>	<p>ok</p>	<p>Faktor2 apa yg dimiliki BMT....</p>	<p>sudah tepat</p>	<p>Tidak ada</p>	<p>Tidak ada saran,</p>	<p>Redaksi pertanyaan perlu disederhanakan agar lebih mudah dipahami oleh partisipan.</p>	
	<p>Konten Item Pertanyaan</p>	<p>Walaupun sdh ada panduan literature yg mendampingi, faktanya responden mlakukan hal ini sukarela. Jarang bisa byk meluangkan waktu. Utk mendpt jawaban yg berguna bgi penelitian maka sebaiknya kata2 yg terlalu akademis di asosiasikan dgn kata yg lbih praktis dan mudah difahami oleh responden.</p>	<p>Masih tumpang tindih antara satu kata dengan kata lainnya</p>	<p>kalo bisa diberi pilihan jawaban dan jawaban kosong untuk tambahan dari responden, karena responden kita orang praktisi yang biasanya males mikir dalam</p>	<p>Ya sdh</p>	<p>sudah sesuai dengan tujuan penelitian</p>	<p>Pertanyaan tersebut relevan. Namun, terkait dengan pertanyaan tersebut dan sebelumnya apakah yang dimaksud adalah solusi yang dimiliki BTM untuk menyelesaikan permasalahan atau hanya untuk menggali lebih dalam SWOT BMT mengenai permasalahan keagenan</p>	<p>Sesuai</p>	<p>Pertanyaan sudah relevan dengan tujuan penelitian, akan tetapi perlu disederhanakan agar lebih mudah dipahami oleh partisipan.</p>	

<p>Item 11: Apakah BMT juga memiliki program pinjaman kelompok (<i>group lending</i>) dan kewajiban bersama (<i>joint liability</i>)? Jika ya, bagaimana mekanismenya?</p> <p>V: 7</p>	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	<p>Apakah BMT juga memiliki program pinjaman kelompok (<i>group lending</i>) dan kewajiban bersama (<i>joint liability</i>)? Jika ya, bagaimana mekanismenya?</p>
	Redaksional Item pertanyaan	Ok	Pertanyaan ini disertai dengan penjelasan terkait kepada pihak BMT	ok	Tdk ada	sudah sesuai	Tidak ada	Tidak ada saran,	Redaksi pertanyaan sudah sesuai akan tetapi perlu disertai dengan penjelasan terkait dengan permasalahan dan teori yang dipakai.	
	Konten Item Pertanyaan	Ok	Pertanyaan ini disertai dengan penjelasan terkait kepada pihak BMT	tepat	sesuai	sudah sesuai dengan tujuan dan akan menjadi data yang sangat membantu dalam analisis dan pemaparan data	Pertanyaan tersebut relevan. Namun, perlu dipertimbangkan apakah pertanyaan tersebut merupakan pertanyaan umum sehingga dapat dikelompokkan di awal	Iya sudah sesuai, karena sebagian BMT punya program untuk kelompok.	Pertanyaan sudah sesuai dengan tujuan penelitian akan tetapi perlu disertai dengan penjelasan terkait permasalahan dan teori yang dipakai.	
<p>Item 12: Apakah BMT juga memiliki program pembinaan sosial? jika ada, bagaimana mekanismenya?</p> <p>V: 7</p>	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	<p>Apakah BMT juga memiliki program pembinaan sosial? jika ada, bagaimana mekanismenya?</p>
	Redaksional Item pertanyaan	Ok	Tidak ada	ok	Tdk ada	sudah tepat	Tidak ada	Tidak ada saran, tidak semua BMT punya program pembinaan sosial, untuk mekanismenya adalah dana qordul Hasan akan di berika untuk permodalan usaha, atau seperti BMT BIF di jogjakarta pemberdayaa mantan PSK adanya pengajian untuk meningkatkan keimanan dan modal usaha.	Redaksi pertanyaan sudah tepat.	
	Konten Item Pertanyaan	Ok	Tidak ada	ok	sesuai	sudah sesuai dengan tujuan penelitian	Pertanyaan tersebut relevan	Iya sudah sesuai.	Konten pertanyaan sudah sesuai dengan tujuan penelitian.	

<p>Item 13: Apa kelebihan dan/atau perbedaan program ini dengan program di lembaga keuangan mikro syariah lainnya atau lembaga keuangan mikro konvensional?</p> <p>V: 7</p>	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	<p>Apa kelebihan dan/atau perbedaan program ini dengan program di lembaga keuangan mikro syariah lainnya atau lembaga keuangan mikro konvensional?</p>
	Redaksional Item pertanyaan	Ok	Tidak ada	ok	Tdk ada	sudah tepat	Tidak ada	Tidak ada saran, setahu saya bedanya BMT dengan LK konvensional itu selain masalah ekonomi juga di kuatkan masalah keagamaannya (keimanan). Klo dengan LK Syariah lainnya rata-rata sama.	Redaksi pertanyaan sudah tepat.	
	Konten Item Pertanyaan	Ok.selain profuk maka program pembinaan sosial terkait dgn keagenan brarti ya	Tidak ada	ok	sesuai	sudah tepat untuk menjadi jawaban atas tujuan penelitian	Pertanyaan tersebut relevan	Iya sudah sesuai	Konten pertanyaan sudah sesuai dengan tujuan penelitian.	
<p>Item 14: Bagaimana proses seleksi atau penyingkiran nasabah pembiayaan usaha mikro BMT?</p> <p>V: 7</p>	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	<p>Bagaimana proses seleksi atau penyingkiran mitra pembiayaan usaha mikro BMT?</p>
	Redaksional Item pertanyaan	Ok	Tidak ada	ok	Tdk ada	hanya istilah nasabah apakah digunakan di dalam BMT? Anggota atau nasabah atau mitra?	Tidak ada	Tidak ada saran, prosesnya calon nasabah datang ke BMT atau ketemu dengan marketing BMT dan mengajukan permohonan pembiayaan dengan mengisi berkas-berkas (form) yang telah di sediakan BMT, kemudian seleksi dari BMT-nya adalah dengan cara mengidentifikasi ke nasabah tersebut dengan melihat dan	Redaksi istilah "nasabah" perlu disesuaikan pada konteks BMT dengan kata "anggota" atau "mitra".	

								mewawancarai ttng usahanya, berapa pendapatannya rata-rata, ada jaminan tidak trs datang dan tanya2 ke tetangga, saudara, teman pengusaha dll tentang nasabah yang mengajukan pembiayaan tersebut dr segi perilaku, moral Hazard dll		
	Konten Item Pertanyaan	Ok	Tidak ada	ok	sesuai	sudah sesuai dengan tujuan penelitian	Pertanyaan tersebut relevan	Sudah	Konten pertanyaan sudah sesuai dengan tujuan penelitian.	
Item 15: Apakah BMT mensyaratkan adanya jaminan dalam memberikan pembiayaan bagi usaha mikro? Jika ya, bagaimana bentuk dan mekanisme pengajuan jaminan tersebut?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Apakah BMT mensyaratkan adanya jaminan / agunan dalam memberikan pembiayaan bagi usaha mikro? Jika ya, bagaimana bentuk dan mekanisme pengajuan jaminan tersebut?
	Redaksional Item pertanyaan	Ok	Tidak ada	ok	Tdk ada	sudah tepat	Tidak ada	Tidak ada saran, jaminan ada bisanya BPKB Mobil, motor atau Surat berharga lainnya	Redaksi pertanyaan sudah jelas dan tepat.	
	Konten Item Pertanyaan	Ok	Tidak ada	ok	sesuai	sudah sesuai dengan tujuan penelitian	Pertanyaan tersebut relevan	Iya.	Konten pertanyaan sudah sesuai dengan tujuan penelitian.	
Item 16: Bagaimana strategi BMT dalam menghadapi nasabah pembiayaan usaha mikro yang tidak memiliki jaminan? Apakah ada kebijakan penerapan jaminan sosial pada BMT? Jika ada, bagaimana penerapannya?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Bagaimana strategi BMT dalam menghadapi nasabah pembiayaan usaha mikro yang tidak memiliki jaminan? Apakah ada kebijakan penerapan jaminan sosial pada BMT? Jika ada, bagaimana penerapannya?
	Redaksional Item pertanyaan	Ok	Tidak ada	ok	Tdk ada	sudah tepat	Tidak ada	Tidak ada saran, ada jaminan sosial, dijamin oleh karyawan/manager/pengurus BMT (karena saudara atau orang terpendang di organisasi)	Redaksi pertanyaan sudah jelas dan tepat.	

	Konten Item Pertanyaan	Ok	Tidak ada	sesuai	sesuai	sudah sesuai dengan tujuan penelitian	Pertanyaan tersebut relevan	Sudah	Konten pertanyaan sudah sesuai dengan tujuan penelitian.	
Item 17: Bagaimana pengaruh strategi yang dilakukan oleh BMT dalam meminimalisir terjadinya masalah keagenan pada pembiayaan usaha mikro?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Bagaimana dampak dari program BMT yang ditujukan dalam meminimalisir terjadinya masalah keagenan pada pembiayaan usaha mikro?
	Redaksional Item pertanyaan	Ini sedikitbingungkan , sebaiknya lbih disederhanakan kimatnya. Bagaimana efek dari program "...." yg ditujukan utk menekan masalah .....(sebutkan jlas masalah keagenannya ).	Pertanyaan cukup jelas	ok	Bagaimana dampak...	sudah tepat	Tidak ada	Tidak ada saran, strategi nya bisa nya di akad	Redaksi pertanyaan perlu lebih disederhanakan agar lebih mudah dipahami oleh partisipan.	
	Konten Item Pertanyaan	Fokus responden utk memahami kalimat hrus dipertimbangkan .	Pertanyaan cukup jelas	tepat	Sesuai	sudah sesuai dengan tujuan penelitian	Pertanyaan tersebut relevan	Sudah sesuai.	Konten pertanyaan sudah sesuai dengan tujuan penelitian, akan tetapi perlu disederhanakan agar lebih mudah dipahami oleh partisipan.	
Item 18: Apa saja contoh nyata keberhasilan strategi BMT dalam meminimalisir masalah keagenan pada pembiayaan usaha mikro?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Apa saja contoh nyata keberhasilan strategi BMT dalam meminimalisir masalah keagenan pada pembiayaan usaha mikro?
	Redaksional Item pertanyaan	Ok	Pertanyaan cukup jelas	ok	Tdk ada	sudah sesuai	Tidak ada	Tidak ada saran, keberhasilannya berupa akad IMBT dan Murabahah bil wakalah	Redaksi pertanyaan sudah cukup jelas.	

	Konten Item Pertanyaan	Ok	Pertanyaan cukup jelas	ok	sesuai	sudah sesuai dengan tujuan penelitian. Berkaitan dengan pertanyaan sebelumnya	Pertanyaan tersebut relevan	Sudah sesuai	Konten pertanyaan sudah sesuai dengan tujuan penelitian.	
Item 19: Sejauh mana proses/mechanisme penyangkutan yang diterapkan BMT berpengaruh dalam meminimalisir masalah keagenan pada pembiayaan usaha mikro?  V: 6 IV: 1	Item pertanyaan Valid/Invalid	Valid	Tidak Valid	Valid	Valid	Valid	Valid	Valid	V: 6 IV: 1	Sejauh mana pengaruh proses/mechanisme seleksi / penyangkutan mitra pembiayaan yang diterapkan oleh BMT dalam meminimalisir masalah keagenan pada pembiayaan usaha mikro?
	Redaksional Item pertanyaan	Ok	Bagaimana proses penyangkutan (ini kalimat belum tuntas, maksudnya penyangkutan apa?)	ok	Tdk ada	Sejauh mana pengaruh proses/mechanisme penyangkutan yang diterapkan oleh BMT dalam meminimalisir masalah keagenan pada pembiayaan usaha mikro?	Tidak ada	Tidak ada saran, sangat berpengaruh contoh karena ada agunan atau dengan akad IMBT/ sewa beli maka nasabah lebih rajin bayar cicilan.	Redaksi kata "penyangkutan" perlu diperjelas terkait maksud dari item pertanyaan tersebut.	
	Konten Item Pertanyaan	Ok	Sudah, tapi kalimatnya belum tuntas	tepat	sesuai	sudah sesuai dengan tujuan penelitian	Pertanyaan tersebut relevan Pertanyaan tersebut relevan	Sudah sesuai	Konten pertanyaan sudah sesuai dengan tujuan penelitian.	
Item 20: Bagaimana pengaruh kewajiban terhadap jaminan (agunan) dalam meminimalkan terjadinya masalah keagenan pada pembiayaan usaha mikro?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Bagaimana pengaruh kewajiban terhadap jaminan (agunan) dalam meminimalkan terjadinya masalah keagenan pada pembiayaan
	Redaksional Item pertanyaan	Ok	Pertanyaan cukup jelas	ok	Tdk ada	sudah tepat	Tidak ada	Tidak ada saran, sangat berpengaruh	Redaksi pertanyaan sudah tepat dan cukup jelas.	
	Konten Item Pertanyaan	Ok	Pertanyaan cukup jelas	ok	sesuai	sudah sesuai dengan tujuan penelitian	Pertanyaan relevan untuk mengukur seberapa banyak permasalahan pembiayaan usaha mikro yang dipersyaratkan agunan dan tidak	Sudah sesuai	Konten pertanyaan sudah sesuai dengan tujuan penelitian.	
Item 21: Bagaimana peran jaminan sosial dalam meminimalkan terjadinya masalah keagenan pada pembiayaan usaha mikro?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Bagaimana peran adanya tanggung jawab bersama (jaminan sosial) dalam meminimalkan terjadinya masalah keagenan pada pembiayaan usaha mikro?
	Redaksional Item pertanyaan	Kalimat praktis utk jaminan sosial atau kata yg dpt diasosiasikan dgn itu akan lebih baik dan	Pertanyaan cukup jelas	ok	Tdk ada	sudah tepat	Tidak ada	Tidak ada saran, sangat berpengaruh	Pertanyaan sudah tepat dan cukup jelas.	

		dpt direspon lbih tepat oleh responden								
	Konten Item Pertanyaan	Ya	Pertanyaan cukup jelas	sesuai	sesuai	sudah sesuai dengan tujuan penelitian	Saya belum pernah mempelajari/meyakini adanya pengaruh peran jaminan sosial pada pembiayaan usaha mikro	Sudah sesuai	Konten pertanyaan sudah sesuai dengan tujuan penelitian, meskipun demikian perlu dicek Kembali terkait adanya pengaruh jaminan sosial pada pembiayaan usaha mikro.	
Item 22: Bagaimana pinjaman kelompok ( <i>group lending</i> ) dan program kewajiban bersama ( <i>joint liability</i> ) berpengaruh dalam meminimalisir masalah keagenan pada pembiayaan usaha mikro?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Bagaimana pinjaman kelompok ( <i>group lending</i> ) dan program kewajiban bersama ( <i>joint liability</i> ) berpengaruh dalam meminimalisir masalah keagenan pada pembiayaan usaha mikro?
	Redaksional Item pertanyaan	Konteks sama , utk definisi masalah keagenan atas point ini sebaiknya sdh dpt hal yg spesifik atas masalah keagenan yg sperti apa.. sebaiknya konkrit.	Pertanyaan cukup jelas	good	Tdk ada	sudah tepat	Tidak ada	Tidak ada saran, sangat berpengaruh karena adanya kelompok pbisa saling mengingatkan	Redaksi pertanyaan cukup jelas akan tetapi pertanyaan terkait masalah keagenan bisa difokuskan ke hal yang lebih spesifik pada konteks yang ada pada BMT partisipan.	
	Konten Item Pertanyaan	Ya	Pertanyaan cukup jelas	lumayan	sesuai	sudah sesuai dengan tujuan penelitian	Pertanyaan relevan	Sudah sesuai	Konten pertanyaan cukup jelas dan sesuai dengan tujuan penelitian.	
Item 23: Bagaimana program pembinaan sosial berpengaruh dalam meminimalisir masalah keagenan dalam pembiayaan usaha mikro?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Bagaimana program pembinaan sosial berpengaruh dalam meminimalisir masalah keagenan dalam pembiayaan usaha mikro?
	Redaksional Item pertanyaan	Ok	Pertanyaan cukup jelas	ok	Tdk ada	sudah tepat	Tidak ada	Tidak ada saran	Redaksi pertanyaan cukup jelas dan sudah tepat.	
	Konten Item Pertanyaan	Ok	Pertanyaan cukup jelas	ok	sesuai	sudah sesuai dengan tujuan penelitian	Pertanyaan relevan	Sudah sesuai	Konten pertanyaan cukup jelas dan sudah sesuai dengan tujuan penelitian.	

Item 24: Apa saja strategi/program yang dapat ditawarkan untuk menjadi solusi masalah keagenan pada pembiayaan usaha mikro di BMT?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Strategi atau program apa sajakah yang ditawarkan oleh BMT agar menjadi solusi masalah keagenan pada pembiayaan usaha mikro?
	Redaksional Item pertanyaan	Ok	Pertanyaan cukup jelas	ok	Tdk ada	Strategi atau program apa sajakah yang ditawarkan oleh BMT agar menjadi solusi masalah keagenan pada pembiayaan usaha mikro?	Tidak ada	Adanya pembinaan tentang keimanan kepada Allah SWT, moral Hazard dan usaha dari awal sampai tumbuh berkembang serta program pembukuan usaha.	Redaksi pertanyaan cukup jelas.	
	Konten Item Pertanyaan	Ok	Pertanyaan cukup jelas	ok	sesuai	sudah sesuai dengan tujuan penelitian	Pertanyaan masih relevan	Sudah sesuai	Konten pertanyaan cukup jelas dan sudah sesuai dengan tujuan penelitian.	
Item 25: Sejauh mana proses penyalangan, kewajiban terhadap jaminan (agunan), dan/jaminan sosial yang diterapkan oleh BMT berperan dalam meminimalisir terjadinya masalah keagenan pada pembiayaan usaha mikro?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Bagaimana proses agunan dan jaminan sosial yg diterapkan BMT dapat meminimalisir "masalah keagenan." Pada transaksi pembiayaan mikro?
	Redaksional Item pertanyaan	Bgaimna proses agunan dan jaminan sosial yg diterapkan BMT dapat meminimalisir "masalah keagenan." Pada transaksi pembiayaan mikro	Pertanyaan cukup jelas	ok	Tdk ada	Sejauh mana peran dari proses penyalangan, kewajiban terhadap jaminan (agunan), dan/jaminan sosial yang diterapkan oleh BMT dalam meminimalisir terjadinya masalah keagenan pada pembiayaan usaha mikro?	Tidak ada	Tidak ada saran, rata-rata klo mau melakukan pembiayaan di BMT harus ada jaminan Nya.	Redaksi item pertanyaan lebih disederhanakan lagi agar lebih mudah dipahami oleh partisipan.	
	Konten Item Pertanyaan	Ya	Pertanyaan cukup jelas	ok	sesuai	sudah sesuai dengan tujuan penelitian	Pertanyaan relevan	Sudah sesuai	Konten pertanyaan cukup jelas dan sudah sesuai dengan tujuan penelitian.	

Item 26: Sampai sejauh mana program pinjaman kelompok ( <i>group lending</i> ) dan kewajiban bersama ( <i>joint liability</i> ) dapat menjadi solusi atas masalah keagenan yang terjadi pada pembiayaan usaha mikro di BMT?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Sampai sejauh mana program pinjaman kelompok ( <i>group lending</i> ) dan kewajiban bersama ( <i>joint liability</i> ) dapat menjadi solusi atas masalah keagenan yang terjadi pada pembiayaan usaha mikro di BMT?
	Redaksional Item pertanyaan	Ok	Pertanyaan cukup jelas	ok	Tdk ada	sudah tepat	Tidak ada	Tidak ada saran, ini menjadi solusi masalah keagenan sekitar 75 %, karena ternyata yang kelompok juga klo tidak ada pembinaan sering tidak punya moral Hazard yang tidak baik.	Redaksi pertanyaan sudah tepat dan cukup jelas.	
	Konten Item Pertanyaan	Ok	Pertanyaan cukup jelas	ok	sesuai	sudah sesuai dengan tujuan penelitian	Pertanyaan relevan	Sudah sesuai	Konten pertanyaan cukup jelas dan sudah sesuai dengan tujuan penelitian.	
Item 27: Sejauh mana program pembinaan sosial dapat menjadi solusi atas masalah keagenan pada pembiayaan usaha mikro di BMT?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Sejauh mana program pembinaan sosial dapat menjadi solusi atas masalah keagenan pada pembiayaan usaha mikro di BMT?
	Redaksional Item pertanyaan	Ok	Pertanyaan cukup jelas	ok	Tdk ada	sudah tepat	Tidak ada	Tidak ada saran, sangat memberikan solusi sekitar 95%	Redaksi pertanyaan sudah tepat dan cukup jelas.	
	Konten Item Pertanyaan	Ok	Pertanyaan cukup jelas	ok	sesuai	sudah sesuai dengan tujuan penelitian	Pertanyaan relevan	Sudah sesuai	Konten pertanyaan cukup jelas dan sudah sesuai dengan tujuan penelitian.	
Item 28: Sampai sejauh mana teknologi atau digitalisasi sistem dapat meminimalkan masalah keagenan pada pembiayaan usaha mikro di BMT?  V: 7	Item pertanyaan Valid/Invalid	Valid	Valid	Valid	Valid	Valid	Valid	Valid	V: 7	Sampai sejauh mana teknologi atau sistem digitalisasi dapat meminimalisir masalah keagenan pada pembiayaan usaha mikro di BMT?
	Redaksional Item pertanyaan	Ok	Pertanyaan cukup jelas	ok	Tdk ada	Sampai sejauh mana teknologi atau sistem digitalisasi dapat meminimalisir masalah keagenan pada pembiayaan usaha mikro di BMT	Tidak ada	Tidak ada saran, tidak terlalu berpengaruh karena rata rata nasabah BMT belum melek dengan internet	Redaksi pertanyaan cukup jelas.	
	Konten Item Pertanyaan	Ok	Pertanyaan cukup jelas	ok	sesuai	sudah sesuai dengan tujuan penelitian	Pertanyaan sangat relevan, karena fungsi agen dapat digantikan dengan teknologi yang bisa menilai karakteristik nasabah BMT	Sudah sesuai	Konten pertanyaan cukup jelas dan sesuai dengan tujuan penelitian.	

<p>Item 29: Apa saran untuk rencana strategis BMT ke depan untuk mengatasi masalah keagenan pada pembiayaan usaha mikro?</p>	<p>Item pertanyaan Valid/Invalid</p>	<p>Valid</p>	<p>Valid</p>	<p>Valid</p>	<p>Valid</p>	<p>Valid</p>	<p>Valid</p>	<p>Valid</p>	<p>V: 7</p>	<p>Apakah rencana strategis BMT ke depan untuk mengatasi masalah keagenan pada pembiayaan usaha mikro?</p>
<p>V: 7</p>	<p>Redaksional Item pertanyaan</p>	<p>Bisa diekslore ke saran yg pling feasible utk dilakukan based on situation in BMT</p>	<p>Pertanyaan cukup jelas</p>	<p>ok</p>	<p>Tdk ada</p>	<p>Apakah rencana strategis BMT ke depan untuk mengatasi masalah keagenan pada pembiayaan usaha mikro?</p>	<p>Tidak ada</p>	<p>Tidak ada saran pada redaksi, sarannya adalah selain ada jaminan dari nasabah harus ada pembinaan juga dr BMT tentang kebutuhan yang di perlukan oleh nasabah seperti pembinaan pembukuan klo blm bisa membuat pembukuan usaha</p>	<p>Redaksi pertanyaan bisa diekslore ke saran yang paling feasible untuk dilakukan berdasar situasi pada masing-masing BMT.</p>	
	<p>Konten Item Pertanyaan</p>	<p>Ok</p>	<p>Pertanyaan cukup jelas</p>	<p>ok</p>	<p>sesuai</p>	<p>sudah sesuai dengan tujuan penelitian</p>	<p>Pertanyaan relevan. Sebagai masukan akhir, sepemahaman saya BMT di Indonesia sangat sedikit yang menggunakan agen untuk menilai karakteristik nasabah. Namun, agen untuk ke depannya dapat membantu BMT setidaknya sebagai second opinion dalam menganalisis calon nasabah peminjam di BMT.</p>	<p>Sudah sesuai</p>	<p>Konten pertanyaan cukup jelas dan sudah sesuai dengan tujuan penelitian. Meskipun demikian, perlu dipertimbangkan Kembali penggunaan istilah agen pada konteks pembiayaan usaha mikro pada BMT.</p>	