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GOVERNANCE AND OUTREACH OF ISLAMIC MICROFINANCE (BMT) TOWARD CASH WAQF

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ABSTRACT

This paper examines the relationship between the determinants of corporate outreach and corporate governance in Islamic microfinance institutions (Baitul Maal wa Tanwil, BMT toward Cash Waqf management using a primary data set built from the concept of Islamic MFIs collected from internal and external respondents. Islamic Micro-finance implements cash waqf management. Using the measurement model and the structural model in Partial least square (PLS), this paper examines the effects of the board and CEO characteristics, type of firm ownership, customer-firm relationship, and competition and regulation on the financial performance of Islamic MFIs and outreach to Islamic Microfinance customers and institutions Cash Waqf. This paper finds that Determinants of governance in microfinance Islamic institutions - BMT in cash waqf management is CEO/chairman duality, internal board auditor, board size, shareholder firm, individual loan, competition, regulated bank, urban market, Islamic microfinance Institutional age, portfolio at risk, firm size, and Human development index (HDI). Outreach governance of MFIs-BMT on cash waqf management is divided into three dimensions, namely: first, the internal

dimensions are; CEO/chairman duality, internal board auditor, the board size, and shareholder firm. Second, the external dimensions are; individual loans, competition, bank regulation, urban market, Islamic microfinance Institutional age. Third, the dimensions of the control factor are; portfolio at risk, firm size, and Human development index (HDI). MFIs-BMT on cash waqf management in Indonesia discussed in this study proves that outreach governance of MFIs-BMT occurs only in external dimensions, including; individual loan, competition, bank regulated, urban market, Islamic microfinance Institutional age. Our research concludes that MFIs in Indonesia focus on individual loans, competition between MFIs and BMTs, are subject to banking regulations, are more developed in rural markets than urban markets, and this dimension of outreach governance depends on the age of MFIs-BMTs.
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Keywords: Islamic Microfinance, Baitul Maal wa Tanwil (BMT), Cash Waqaf Institution, Outreach and Governance, Partial Least Square (PLS)

INTRODUCTION

This study examines the impact of governance mechanisms on the dual mission of Islamic microfinance institutions (LKM Syariah) or Baitul Maal wa Tanwil (BMT) and Cash Waqaf Institutions as sustainability in providing financial and banking services for micro-enterprises and low-income families. This study identifies three dimensions of this problem: the vertical dimension between owners and management, the horizontal dimension between Islamic MFIs and cash waqf and their customers, and the external governance dimension. Recommendations for better governance are mainly on the first and third dimensions, according to Rock et al. (1998), Otero and Chu (2002), and Helms (2006) suggest importing best practices in governance from developed countries, such as board independence and shareholder ownership. Meanwhile, Van Greuning et al. (1999) and Hardy et.al. (2003) argue for better regulation of MFIs.

BMT is a sharia financial institution that operates using a combination of the concepts of "Baitul Maal" and "Baitu Tamwil" with its operational target focusing on the Small and Medium Enterprises (SME) sector. The concept of Baitul Maal means that BMT acts as a socio-religious institution that has the function of receiving Zakat, Alms, Infaq, and Waqf funds and using them for the community. While in the Baitul Tamwil concept, BMT has a role as a business institution or financial institution that aims to seek profit (profit-oriented), such as opening a Toserba (convenience store) or offering savings and loan products to the public. However, if we look at the practice in the field, BMT is more likely to act as a sharia financial institution that offers savings and loan products to the public based on sharia principles.

Governance and Outreach of Islamic MFI

Governance (Governance) is about achieving company goals. The first objective of the MFI is to reach more clients in the poorer sections of society, and the second goal is financial sustainability. This study analyses the relationship between governance mechanisms and outreach.

The problem of incentives in Microfinance Institutions has at least two dimensions: one between owners and management (including the board), and the other between the MFI and its clients (Macey and O'Hara, 2003). Overview by Becht et al. (2003) and Hermalin and Weisbach (2003) show that governance in the owner-board dimension is important in general, while Rock et al. (1998), Otero and Chu (2002), and Helms (2006) highlight its particular importance in microfinance. On the MFI-customer dimension, MFIs are subject to credit risk assessment and repayment problems because loan customers usually have little or no collateral (Armendariz de Aghion and Morduch, 2005). Microfinance initiatives are finding new ways to address this problem through group lending, character lending, and the gradual development of credit histories. In group lending, using either a solidarity group or a village bank, the MFI delegates much of the screening and monitoring effort to the group.

In contrast, the customer's relationship with the MFI is more direct regarding individual lending. In addition, the unique nature of banks and financial institutions as providers of financial infrastructure often requires public regulation of bank/financial institution-customer relations. Therefore, studying MFI governance requires three considerations: the relationship between the owner and the board, the relationship between the MFI and its customers, and the external conditions of competition and regulation. Table 2 summarizes the independent variables, governance factors, and hypotheses related to outreach.

In the three dimensions of governance, namely: First, the board-owner dimension concerns the composition of the board and the type of ownership.

The board composition variables are CEO/chairman duality, international director, internal auditor, and board size. CEO/chairman duality can signify CEO power (Hermalin and Weisbach, 1991, 1998), whereby the CEO can pursue policies that result in personal gain. The Cadbury Committee (1992) advised against duplication of this role. However, duality can increase the effectiveness of decision-making. This ambiguity may explain why Brickley et al. (1997) do not find that firms with CEO-chair separation outperform those with CEO/chair duality. Oxelheim and Randøy (2003) find that firm performance increases with the presence of international directors.

Steinwand (2000) recommends that internal auditors in MFIs report directly to the board. Ideally, internal auditors should provide the board with an independent and objective assessment of the MFI's operations, improving the MFI's financial and social performance.

Larger boards can encourage members to be independent in their monitoring responsibilities, allowing for greater CEO independence. Yermack (1996) and Eisenberg et al. (1998) reported that a larger board was associated with lower firm performance, measured as Tobin's Q or ROA.

Bennedsen et al. (2008) confirmed a negative relationship in small family firms. Hartarska (2005) confirmed the results of the ROA regression for MFIs. Adams and Mehran (2003a) present conflicting evidence from banking firms in the United States, and de Andres and Vallelado (2008) agree based on Spanish data. Many MFIs are organizations non-profit organizations (NPOs). Handy (1995) proposes that board members in NPOs offer their reputation as collateral and Speckbacher (2008) argues that NPOs need larger boards because they lack owners with monetary incentives to monitor their investments. Referring to Hartarska (2005) findings, the Islamic MF research results with cash waqf expect a larger board (Board size) to reduce company performance.

Legal incorporation or type of ownership can play a role in MFI performance. Similar to ordinary banking (Rasmussen, 1988; Hansmann, 1996), MFI ownership differs significantly (Labie, 2001; Mersland, 2009). NPOs are often considered a weaker structure because MFIs lack owners with operating financial shares (Jansson and Westley, 2004), this finding leads to lower financial performance than shareholder firms (SHF). Therefore, Ledgerwood and White (2006) and Fernando (2004) support the transformation of NPOs into SHF. However, NPOs are believed to be more effective in reaching poor customers.

This finding implies that SHF should show better financial performance but reach fewer poor clients than NPOs. However, Mersland and Strøm (2008) found that the performance of SHF and NPO was equally good. Incentive issues between owners and managers may be more prominent in NPOs, but NPOs have the compensatory benefit of reducing adverse customer selection and avoiding moral hazards (Hansmann, 1996; Desrochers and Fischer, 2002; Mersland, 2009). better able to enter the local information network. In comparison, Caprio and Vittas (1997) and Cull et al. (2006) proved by asserting that many SHFs are not run according to the shareholder value model because, generally, MFIs are committed to reaching the poor (Reille and Forster, 2008). This study confirmed the findings of Valnek (1998), Crespi et al. (2004), and Mersland and Strøm (2008) that NPO (Islamic MF with Cash Waqaf) performs as well as SHF.

Stakeholders on the board arguably influence the MFI's governance, Hartarska (2005) finding that director employees are negatively related to financial performance and outreach. The research data found that no stakeholder group improved the company's performance or outreach (unpublished data). External governance mechanisms, such as product market competition and regulation, may be relevant for Islamic microfinance institutions (Islamic MFIs). Generally, the more intense the competition, the fewer owners will need internal governance mechanisms (Hart, 1983; Schmidt, 1997). However, Nickell (1996) argues that because increased competition can reduce costs, the negative effects of lower product prices may not be outweighed. Thus, the effect on performance is uncertain. Petersen and Rajan (1995) argue that banks and financial institutions earn rent from survivors in long-term relationships. When relationships are damaged by competition, banks/financial institutions stop lending to customers, which is risky and expensive. This can reduce outreach.

METHODS

This study uses a methodology with a qualitative approach with quantitative methods. Quantitative data is collected and constructed based on the theory that supports it. Data in the form of questionnaire answers were analyzed and integrated (Inquiry and sequentially concept). Data Analysis was done to adjust the research conducted with the research method used to gain a deeper understanding of the relationship and influence between cash waqf variables, Baitul Mal wa Tamwil, and Microfinance.

Table 1: Definition of Operational Variables and Hypotheses.

Variables	Explanation	Hypothesis	
		Governance	**Outreach**
CEO/Chairman Duality (CEO)	CEO and Chairman are the same person	+/-	-
Internal Board Auditor (AUDIT)	Islamic MFI has an internal auditor reporting to the board	+	-/+
Board Size (BORDSZ)	The number of directors	-	-
Shareholder Firm (SHF)	A shareholder firm	+	-
Individual Loan (LOAN)	Loans are made mainly to individuals	+	-
Competition (COMPET)	A self-constructed measure of the local level of competition	-	+
Bank regulated (REGUL)	The Islamic MFI is regulated by banking authorities	-/+	+
Urban Market (URBAN)	The market served is urban only	-	-
Islamic Microfinance Age (IMF)	Years of experience as an Islamic MFI		
Portofolio at Risk (RISK)	The fraction of the portfolio with more than 30 days in arrears		
Firm Size (SIZE)	The natural logarithm of assets		
Human Development Index (HDI)	A Composite country Index covering life expectancy, education,		

	and income (GDP per capita)	

Measurement Model Results (Outer Model)

This measurement model connects the indicator items as manifest variables that explain the latent variables as supporting concepts that meet the criteria of validity and reliability as a measuring tool; the results are as follows:

Table 2: Outer Loading Stage 2 Results

Code	Loading	Evaluations	Code	Loading	Evaluations
COMPET1	0,788	Valid	RISK1	0,724	Valid
COMPET2	0,772	Valid	RISK2	0,714	Valid
HDI2	0,748	Valid	SIZE2	0,777	Valid
IMF2	0,729	Valid	CWLS1	0,712	Valid
LOAN1	0,717	Valid	CWLS2	0,999	Valid
LOAN2	0,753	Valid			

Source: Processed Data (2023)

Table 2. shows The value generated by each indicator (manifest variable) to measure latent variables, such as CEO/chairman duality, internal board auditor, board size, shareholder firm, bank regulation, competition, individual loan, urban market, MFI age, portfolio at risk, firm size, and Human Development Index (HDI). This variable is divided into three dimensions of outreach. MFI-BMT manages cash waqf: First, internal dimensions, including CEO/chairman duality, internal board auditor, the board size, shareholder firm, and bank regulation. Second, the external dimension consists of a competition, individual loans, the urban market, and MFI age. The third is the dimension of control factors: portfolio at risk, firm size, and the Human Development Index (HDI).

Structural Model Results (Inner Model)

Table 3: T-Statistic

	Cash Waqaf Institusinal	T-Statistic	P- Value
Governance Islamic MFI → Cash Waqaf Institusional	0,675	5,659	0,0000

Source: Processed data (2023)

Table 3 shows that the relationship between these two positive variables between Islamic Governance MFI and Institutional Cash Waqf has a significant level of 5.656 > 1.86 and a P-value of 0.0000 < 0.05; this proves the level of significance of this finding that The internal governance dimension shows that there is no relationship and there is no outreach between MFIs (BMT) on cash waqf management, where the correlation value of each variable is very low, namely: CEO/chair duality, internal board auditor, Board size, shareholder firm, and bank regulation. This happens because half of the MFIs (BMT) managing cash waqf in the sample of this study, the CEO or chairman of the MFI (BMT) has concurrent positions. These results cannot reveal whether the MFI (BMT) managing cash waqf would be better regulated by a CEO who is not chairman MFI (BMT). This finding was previously referenced by Brickly et.al. (1997).

RESULT AND DISCUSSION

The results of hypothesis testing on Individual Loans at LKM-BMT with Cash Waqaf indicate that individual loans are a significant variable in this study; loans with business feasibility assessment (LOAN1) have a correlation of 71.7% and loans with collateral feasibility assessment (LOAN2) correlated by 75.3%. This shows that the sustainable financial performance of MFIs-BMT based on Cash Waqf can be achieved with individual and group loans. However, the proposed comparative efficiency in group lending is not confirmed.

The results of the external competition governance mechanism (COMPET) LKM-BMT with cash waqf management shows positive and significant results for competition between individual LKM-BMT (COMPET1) correlates with 78.8%. In industry competition, MFI has a correlation of 77.2% in the MFI-BMT study. Thus, it appears that the performance of MFI-BMT can increase with the increasing competition; this result supports th e opinion of Nickell (1996), because the first entrants become more efficient when new MFIs enter the MFI-BMT industrial market.

The results on the Urban market variable show that the MFI-BMT urban market with cash waqf primarily concentrates its business only in rural areas. The result is very low, given the difficulty of reaching rural areas (Helms, 2006). Currently, most MFIs only serve the rural market, and only a few serve both.

In the results of the Islamic Microfinance age (MFI age), this study shows that MFIs are generally young, although some institutions can trace their microfinance activities before the country's independence, when these microfinance institutions began to provide loans to small farmers, small traders, etc. However, MFIs generally have little time to build relationships with their clients. The results of the Portfolio at Risks show a positive and significant correlation between the credit risk profile (RISK1) of 72.4% and the interest rate risk profile of 71.4%. This result is counter-intuitive considering that the LKM-BMT is a sharia-based microfinance institution that must be analyzed further.

The results of the Human Development Index (HDI) show that the Human Development Index (HDI) in companies with human resources from various backgrounds, the inclusion of HDI can capture some of the differences in microfinance institutions. Firm size results show that the CEO/chairman can increase the number of customers; this is the priority of the firm size effect. The variable between CEO and Chairman duality interaction with firm size has a positive and significant correlation. Then by institutionalizing duality, MFI-BMT can pursue organizational goals by maximizing firm size, according to research by Berle and Means (1932).

Table 4: R-Square

Variable	R Square	R Square Adjusted
Cash Waqf Institutional	0.455	0.449

Table 4 shows the simultaneous correlation of indicators of the LKM-BMT governance variable to the institutional cash waqf variable, which has a value of 45.5%. Moreover, the remaining 54.5% is another variable that is not a factor in this study. The overall conclusion is that several mechanisms of traditional internal and external corporate governance factors with controlling and outreach factors significantly affect the institutional or management of Cash Waqf.

CONCLUSION

Determinants of governance in microfinance institutions - BMT in cash waqf management are CEO/chairman duality, internal board auditor, board size, shareholder firm, individual loan, competition, regulated bank, urban market, Islamic microfinance Institutional age, portfolio at risk, firm size, and Human development index (HDI).

Outreach governance of MFIs-BMT on cash waqf management is divided into three dimensions, namely: first, the internal dimensions are; CEO/chairman duality, internal board auditor, the board size, and shareholder firm. Second, the external dimensions are; individual loans, competition, bank regulation, urban market, Islamic microfinance Institutional age. Third, the dimensions of the control factor are; portfolio at risk, firm size, and Human development index (HDI).

MFIs-BMT on cash waqf management in Indonesia in this study proves that outreach governance of MFIs-BMT occurs only in external dimensions, including; individual loan, competition, bank regulated, urban market, Islamic microfinance Institutional age. This means that MFIs in Indonesia focus on individual loans, competition between MFIs and BMTs, are subject to banking regulations, are more developed in rural markets than urban markets, and this dimension of outreach governance depends on the age of MFIs-BMTs.

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