EXAMINING THE OUTREACH OF ISLAMIC CHARITY BASED MICROFINANCE PROGRAMMES: EMPIRICAL EVIDENCE FROM INDONESIA

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ABSTRACT

One of the advantages of using Islamic social funds is the increased ability of microfinance institutions to provide financial services to the poor. This study aims to (1) investigate the characteristics of the clients of Islamic Charity Based Microfinance (ICBM) programmes; (2) test whether the clients of ICBM programmes are more vulnerable than a non-client group; and (3) discuss the rationale for excluding the poor from zakat-based microfinance programmes. The study examined the microfinance programmes of various zakat institutions, namely Baitul Maal Muamalat (BMMI), BAZNAS and Baitul Maal Beringharjo (BMB). A total of 236 respondents made up of the clients and non-clients of three case study institutions participated in this study. The data were analysed using a binomial logit model to evaluate the factors affecting client participation in ICBM programmes in Indonesia. The findings show that the ICBM clients and non-clients have a similar demographic profile and that the majority of ICBM clients, while living above the national poverty line, live perilously close to its edge. Using logistic regression, the study found that the higher the client's income level, the greater their probability of being selected for the programme. This finding contradicts the existing Islamic microfinance literature which claims that ICBM institutions in general could demonstrate the capacity to extend their services more widely to the poorest if Islamic charity was the main source of microfinance funding. The study highlights some of the potential barriers to including the poor in microfinance, including an institutional selection policy and self-exclusion factors.

Keywords: Islamic Charity, Microfinance, Non-Profit Institutions.
JEL Classifications: G29; I38; L30.

I. INTRODUCTION

1.1. Background

The poor, who are supposed to be the main clients of microfinance, are often unable to benefit from microfinance for several reasons. Problems related to asymmetric information, high operational cost and adverse selection have been cited as major constraints for financial institutions in providing microfinance. Small loans are generally considered too costly to administer and do not generate sufficient revenue for the institution (Ayayi & Sene, 2010). Therefore, continuing subsidies, in the form of low-cost funding injections, may be necessary to enable institutions to achieve financial sustainability and more extensive outreach (Armendáriz & Morduch, 2005). However, a dependency on subsidies has also been cited as one of the major constraints on the growth of microfinance (Ledgerwood, 1998).

Alternatively, certain microfinance institutions have decided to adopt principles and charge commercial rates to clients. The idea is that, in order to reach a large number of clients, the institution has to be profitable and have access to various types of capital, including commercial capital (Robinson, 2001). Thus, while the application of commercial principles and the transformation from donor dependency into profit-seeking institutions offers solutions, it may also force institutions to shift their market focus in order to reduce their operational costs by serving more accessible clients and targeting less risky consumers (Zeller & Meyer, 2002). Consequently, a large number of the poorest of the poor may be excluded from accessing microfinance services as certain microfinance institutions have shifted away from their original mission of serving the poor (Hashemi & Umaira, 2011; Morduch & Haley, 2002).

Currently, there is increasing discussion in the literature as to how microfinance can return to its original mission of serving the poor in a sustainable way (see Hashemi & Montesquiou, 2011; Simanowitz & Walter, 2002). Despite the idea of microfinance commercialisation, many microfinance providers continue to take advantage of various forms of subsidy, including charitable donations. It is clearly evident that many faith-based microfinance institutions (MFIs) continuously depend on religious charity to provide microfinance programmes.

In Indonesia, some zakat institutions use Islamic charitable donation funds in the form of zakat, infaq and shadaqa to continuously provide microfinance services to the poor. One of the advantages of utilising Islamic charity in microfinance initiatives is the ability to facilitate the participation of the poorest of the poor in microfinance programmes (Ahmed, 2002; Obaidullah, 2008). Islamic charity can be utilised in the provision of social development programmes to more effectively address the various barriers that may constrain the participation of the poorest in microfinance. Despite the availability of Islamic charity, poverty and financial exclusion continues to be widespread in Indonesia. Of the 12.5% financially vulnerable sector, fewer than half have access to financial services (Bank Indonesia, 2013) . Existing providers of microfinance tend to target only a specific segment of the population and as such may fail to provide financial services to poor clients (Nugroho, 2010). This study is interested in examining whether, by using Islamic social funds, zakat institutions are able to provide microfinance services for poor and very poor clients who are not served by existing MFIs in Indonesia.

Previous research on the use of Islamic charity in microfinance has tended to focus more on impact studies in terms of the impact on the welfare and poverty of clients after participating in Islamic Charity Based Microfinance (ICBM) programmes (Beik, 2009; Iqbal & Shafiq, 2015). However, studies that evaluate outreach – the ability of microfinance to reach clients with certain characteristics – are still very limited. Research discussing outreach has been presented by Tamanni and Liu (2015) who found that Islamic MFIs had better poverty-oriented outreach compared to conventional MFIs. This study differs from previous studies as it was conducted in case study institutions that use Islamic charity funds for microfinance. As stated in the literature, the use of Islamic charity in microfinance should facilitate the targeting of the poorest clients who have not previously been served. This research will add to calls for literature with a greater level of empirical evidence pertaining to the benefits of utilising Islamic charity in microfinance by highlighting the ability of ICBM to include the more vulnerable clients in society.

1.2. Objective

The objectives of the study are to 1) investigate the characteristics of the clients of ICBM programmes; (2) test whether the ICBM programme clients are more vulnerable than a non-client group; and (3) discuss the rationale for excluding the poor from zakat-based microfinance programmes.

II. LITERATURE REVIEW
2.1. Background theory

MFIs have three performance indicators in the form of sustainability, outreach and impact, well known as the triangle of microfinance (Zeller and Meyer, 2002). MFIs focus not only on generating profit to achieve financial sustainability but also on providing financial services for the poor, with the aim of encouraging this group to engage in income-earning activities and accumulate wealth.

Outreach, as one of the indicators of microfinance performance, can also be determined by the ability of MFIs to effectively and efficiently deliver high-quality services to a diverse range of poor clients. From the donor perspective, a measure of outreach is crucial in order for sound investment decisions to be made so that funds can be allocated to those programmes most likely to have a significant impact on poverty reduction. Additionally, from the perspective of the microfinance institution, a measure of outreach provides information in relation to the characteristics of the clients and the distinctive challenges and issues they face. This information is important in enabling institutions to custom-design products and services that meet their clients' specific needs.

Outreach can be measured in two dimensions: breadth and depth. Breadth refers simply to the scale of the microfinance institution's activities (Ledgerwood, 1998). More specifically, it refers to the number of clients the institution serves, its product range and the coverage of its programmes. Breadth is an important issue as institutions generally have limited budgets for loan disbursement, which may restrict their capacity to provide microfinance services to all poor people. Although it may be straightforward to measure the breadth of outreach, no single

measurement is capable of providing a complete picture of the capacity of a particular microfinance institution to reach a particular level of the poor. It can be challenging for MFIs to achieve sufficient depth of outreach. The common key depth-related question is 'Can microfinance reach the poorest of the poor in the programme?' This is a complex question to respond to as, on the one hand, success in reaching the poorest means that one of the objectives of microfinance has been realised, namely addressing poverty alleviation; on the other hand, however, high costs may be incurred in reaching the poorest, risking institutional sustainability. Further challenges to serving the poorest may arise due to the lack of capability of the poorest to participate in microfinance. As such, MFIs need to address ways of building the capability of the poorest and, in so doing, enhance their prospects for participation.

As a microfinance institution becomes more commercially oriented, issues related to mission drift can arise. In such instances, the institution may attempt to achieve a specific market share in order to reduce its operational costs by targeting more accessible and less risky consumers. Rhyne (2005) defines mission drift as a shift from offering small loans to the poor to offering larger loans to significantly less financially needy clients. Zeller and Meyer (2002) argue that this tradeoff may result in fixed costs accounting for a large proportion of the total transaction cost, with the effect that smaller loans or smaller deposits have higher unit costs compared to those for larger financial transactions. Furthermore, Ledgerwood and White (2004) note that mission drift might be necessary as a means of recovering the high costs of transforming the institution into a profit-seeking institution. The institutions tend to seek higher-income clients that may offer them the potential to generate greater profits.

Similar to debates within conventional microfinance discourse, issues around the question, 'Should Islamic microfinance focus on providing financial services to the poor and the poorest clients?' are at the forefront of debates relating to the implementation of Islamic microfinance programmes. According to some researchers, many Islamic finance scholars share the view that Islamic microfinance should be integrated with Islamic charity institutions in order to provide improved and expanded services for whole segments of the poor (Ahmed, 2007; Hassan, 2010; Obaidullah, 2008) . The incorporation of Islamic charities as a significant and additional source of microfinance funding will be beneficial in terms of increasing the sustainability of MFIs since this type of funding is non-interest bearing. Islamic microfinance may use Islamic charitable funds in a complementary way to finance non-investment activities, such as assisting the poor to meet their basic needs, conducting training to enhance borrowers' skills and capabilities, and contributing to other community development activities. These complementary activities may reduce the possibility of clients using their loan funds for non-productive purposes (Ahmed, 2002). This may lead to the minimisation of the loan repayment default rate. Futher, Ahmed (2002) suggested that Islamic charity and microfinance can be seen as complementary and as such, in concert, have the potential to form collaborative partnerships in the distribution of charitable funding.

In addition, from the perspective of microfinance, the complementary and collaborative use of Islamic charity and microfinance has two main advantages: it increases financial inclusion and enhances institutional sustainability. Taking

the first advantage, the poorest are excluded from microfinance services because they continue to struggle to meet their basic survival needs. Scholars argue that Islamic microfinance can utilise *zakat* funds to provide for these basic needs and to fund training to increase the skills of the poorest of the poor (Ahmed, 2007). Furthermore, Obaidullah (2008) believes that Islamic charity has a role to play in assisting the economically inactive poor to become economically active and to facilitate their greater involvement as participants in microfinance. Islamic charity can be distributed in the form of no-interest loans that can be accessed by all segments of the poor, thereby increasing financial inclusion in Muslim countries.

In relation to the second advantage, the use of Islamic charity in microfinance could also enhance the financial sustainability of Islamic MFIs. Mohieldien et al. (2011) argued that the use of charity as a source of funds will reduce the financial costs of MFIs and increase operational efficiencies. It has been argued that one of the main reasons for the high rates of non-performing loans in MFIs is the clients' use of funds for direct consumption purposes as opposed to productive income-generating purposes. In using charity to take care of clients' basic needs, Islamic microfinance can reduce the possibility of asymmetric information and moral hazard problems and as an outcome, this may lead to better loan repayment rates and increased financial sustainability (Ismail & Possumah, 2013).

There are two models of the integration of Islamic charity in microfinance: the pure charity model and the integrated model. The pure charity microfinance model uses a combination of Islamic charity funding sources to provide both social and commercial services. *Zakat*, as a compulsory Islamic levy, is mainly used to provide resources that enable the poor to meet their basic needs and for skills training programmes, while voluntary types of Islamic charity – *shadaqa* and *waqf* – can be used to provide funds for commercial services (Kaleem & Ahmed, 2009; Obaidullah, 2008). *Zakat* is specifically designed to fund the provision of resources to enhance client well-being and expand the capabilities of the poorest. *Zakat* can be used to fund social services in three key areas: providing resources to enable clients to meet their basic needs, providing training and skills enhancement programmes and providing capital grant/interest-free loans for the initial capital. In Indonesia, the pure charity model is similar to the microfinance programmes conducted by zakat institutions.

The second model presents an integrated model of Islamic charity and Islamic MFIs as discussed by Ahmed (2007), Obaidullah (2008) and Hassan (2010). The integrated model uses a combination of commercial funds and Islamic charity. The commercial funds are used to finance commercial services, while Islamic charity is used to finance social services. Islamic charity plays an important role in addressing the adverse circumstances in which the poorest find themselves prior to participating in microfinance programmes. Similar to MFIs, the integrated model offers commercial services such as micro saving and micro-credit facilities, micro-insurance and micro-leasing using Islamic financial schemes of transactions. However, there may be many challenges in the implementation of this integrated model due to the conflicting organisational culture, policy and regulatory framework between the social and commercial functions within the integrated model itself.

2.2. Previous studies

The use of zakat for microfinance in Indonesia is also well known as productive zakat and has attracted significant attention as a concept in recent times. The main motivation for the use of zakat funds and Islamic charity for microfinance is to overcome the problems arising from conventional MFI in relation to balancing commercial and social goals (Obaidullah, 2010). The use of zakat funds and Islamic social funds is expected to increase financial and social exclusion, in the sense of being able to serve people who have previously been excluded from microfinance services (Ascarya, Rahmawati, & Tanjung, 2018).

Previous research on the use of Islamic charity funds for microfinance can be divided into various main topics. One of the most discussed topics is how to design models of integration between Islamic social funds and microfinance (Ahmed, 2007; Ali, 2014; Obaidullah, 2008). Most researchers believe that Islamic social funds can be integrated with microfinance through redistribution mechanisms, which are used for social development projects that benefit the poor and very poor through the provision of education, training, health facilities, basic needs fulfilment and capital to start a business. The model of integration is similar to the microfinance model run by BMT in Indonesia in that there is a social unit that collects Islamic charity with the aim of providing qard hassan or interest-free financing to the poor (Ascarya et al., 2018).

Furthermore, research on Islamic charity and microfinance has also focused on the impact of ICBM programmes. Most of the impact studies have confirmed that productive zakat plays an important role in poverty alleviation and empowerment. For example, Khatimah (2004) studied the impact of productive financing on the Community Development Cycle programme in Dompet Dhuafa. Khatimah (2004) found that many participants were able to generate substantially increased income after receiving *zakat* funding. Furthermore, she found that variables such as gender, education level, total *zakat* received and the clients' business type, when taken together, significantly influenced the clients' income levels. Beik's (2009) study explored the impact of receiving *zakat* funding on the welfare of 50 households in Jakarta's Dompet Dhuafa, before and after receiving *zakat*. By utilising several methods of analysis – such as headcount ratio, poverty gap indices, the Sen Index and the Foster, Greer and Thorbecke Index – Beik (2009) found that *zakat* was able to reduce the number of families estimated to be poor by 10%, reduce the poverty and income gap, and lessen acute poverty conditions. Therefore, Beik (2009) concluded that *zakat* has a very high potential to reduce poverty in Indonesia. Further, Nurzaman (2011) explored the relationship between the use of *zakat* and human development. Rather than using economic indicators, he used other indices such as a knowledge index and a life expectancy index. The results contradicted two previous studies by Khatimah (2004) and Beik (2009). He also found that *zakat* basically had no direct effect on the HDI value of *zakat* recipients. However, despite highlighting possibilities for successful outcomes in the alleviation of poverty through *zakat*-funded initiatives, the findings of these studies may be limited in terms of what they can claim, specifically in relation to comparisons between the welfare status of recipients before and after receiving *zakat* funds. Studies on the impact of a specific *zakat*-funded programme should be conducted for longer time frames, allowing two levels of evaluation: at the beginning of the programme and

after a specific time period. Asking participants to provide their historical data, such as information relating to income, can potentially lead to data bias as people may not have reliable records of such data.

Another research topic in this field also discusses whether the use of Islamic social funds is capable of providing financial services to the very poor who have not been served. An empirical study by Tamanni and Liu (2015), using a sample of 7919 MFIs, found that Islamic microfinance has pro-poor characteristics compared to conventional MFIs. They found that Islamic MFIs have lower profitability and serve people who are more in need compared to conventional MFIs. Yet Tamanni and Liu (2015) did not discuss whether the performance of IMFIs is influenced by Islamic charity as a source of funds. Research specifically discussing the depth of outreach of ICBM was presented by Iqbal and Safiq (2015) and Ahmad (2018). They examined the outreach performance of Al Akhuwat, a non-profit MFI in Pakistan that uses Islamic charity as its source of funds. Both studies found that Al Akhuwat in Pakistan had successfully selected marginalised client segments such as widows and people in debt using the qard al hassan mechanism. Their studies also found that Al Akhuwat had successfully empowered women borrowers in many aspects such as improved self-confidence, a greater sense of financial stability, improved relationships and a sense of control in life.

III. METHODOLOGY
3.1. Data
To achieve the research objectives, this study collected primary data from the survey questionnaires and secondary data from the annual reports of the ICBMs. The population of this study comprises the clients of ICBM programmes. The size of the population in this study is unknown since ICBM programmes are not obliged to report their implementation to any government authority. Given an unknown population size, based on the study by Hair et. al (2010), the sampling size should be at least 5–10 times the number of explanatory variables. A total of eight explanatory variables are used in this study; thus, the sample should contain at least 80 participants. A total of 270 questionnaires were collected from ICBM clients and non-clients in Jakarta Bogor Tangerang Bekasi (Jabodetabek) and Yogjakarta. Jabodetabek and Yogjakarta were selected as the survey locations as 90% of the BAZNAS, BMT Beringharjo and BMMI ICBM programmes are conducted in those areas. The answers to the questionnaire were then evaluated for completeness and only 236 questionnaires were analysed further in this study.

The survey questions covered several areas, including the demographic profile of household members, the means of income generation, consumption expenditure, and loan and savings information. The survey respondents included ICBM programme clients and the members of a non-client group, including some who lived near the clients but had not themselves been selected as clients of the ICBM programmes. The ICBM clients had participated in the institutions' programme for less than three months. The study selected more recent clients in order to examine their initial circumstances at the time they joined the programme. The non-client respondents closely matched the ICBM clients demographically and in income levels, but they differed with respect to their non-involvement

in an ICBM programme. The non-clients were also selected as respondents in order to create a comparable group. The comparisons made between the ICBM clients and non-clients aimed to provide a basic understanding of the institutions' preferences and priorities in terms of client selection. In the pilot study conducted as part of this study, due to literacy limitations among some of the participants, the questionnaires were distributed using the interviewer-administered method, where the researcher puts the questions directly to the participants and provides assistance where required to help them complete the question response sheets. This data generation method requires sufficient time.

3.2. Model Development

This study argues that ICBM should play a greater role in providing services for socially and economically disadvantaged prospective clients. The use of Islamic charity funding sources would enable the institutions to extend financial services to the poorest of the poor (Ahmed, 2002; Mohieldien et al., 2011). Islamic charity can be utilised to provide social development programmes to more effectively address the various barriers that may constrain the participation of the poorest in microfinance (Ahmed, 2002; Obaidullah, 2008). From this background and context, it is proposed that ICBM institutions that benefit from Islamic resources have an obligation to serve the poor and the poorest rather than more financially secure clients. This proposition will be developed into a model by comparing the characteristics of the clients and non-clients of ICBM. The proposition is thus developed as follows: ICBM programmes select clients with a more vulnerable profile than non-clients.

To answer the research questions, this study constructs a model of client selection for each ICBM case study sample. The dependent variable to be examined is the participation of a respondent in ICBM. Y is a categorical variable, with 1 if the respondent is a client of an ICBM institution, and 0 if the respondent is a non-client of an ICBM institution.

Based on the literature, client participation in a microfinance programme is determined by several factors. These include demographic information such as the gender, age and family size of the clients (Bezboruah & Pillai, 2013), information related to income and expenditure (Anjugam & Ramasamy, 2007), education (Muhongayire et al., 2007) and business and health problems (Zeller & Meyer, 2002). Those factors are used in the model as explanatory variables. The explanatory variables are used to measure client vulnerability. Based on the model proposition, a respondent with a more vulnerable profile (such as a lower annual per capita income, lives in a larger family size, is older, has a shorter schooling period, and has more business and health problems) has a higher probability of being selected as an ICBM client.

3.3. Method

The proposition of this study will be tested through the application of binomial logit regression modelling to provide information about the criteria used by ICBM to select clients. A binomial logit model is a type of logistic regression model that

is used in specific cases where the dependent variable includes two categories (King, 2008). In this case, the dependent variable is whether the respondent can be categorised as "being selected" or "not being selected". Therefore, the dependent variable is a type of categorical variable. In notation, Y=1 if the respondent is selected, and Y=0 if the respondent is not selected.

The participation of the respondents in the ICBM programme can be influenced by several explanatory variables, including X1=annual per capita income, X2=monthly per capita expenditure, X3=age, X4=size of the family, X5=education period, X6=gender of household heads, X7=health problem and X8=business problems. The scale of the independent variables includes both categorical and continuous data. Based on the scale and characteristics of the data, binomial logit regression is the most suitable model for estimating client participation in an ICBM institution.

King (2008) presents the initial logistic probability model as below:

$$\widehat{Y} = P = \frac{\exp(\hat{a} + \hat{b}_1 X1 + \hat{b}_2 X2 + \cdots + \hat{b}_n Xn)}{1 + \exp(\hat{a} + \hat{b}_1 X1 + \hat{b}_2 X2 + \cdots + \hat{b}_n Xn)} \tag{1}$$

Where Y represents the probability of a group membership. In this case, Y represents the probability of a respondent being selected as a client of ICBM given the explanatory variables. Since Y is the exponential term, its interpretation is not straightforward. Therefore, a transformation of Y is needed. This can be done by multiplying both sides of the equation with:

$$1 + \exp(\hat{a} + \hat{b}_1 X1 + \hat{b}_2 X2 + \cdots + \hat{b}_n Xn) \tag{2}$$

Then, the next equation can be derived as below:

$$\frac{P}{1-P} = \exp(\hat{a} + \hat{b}_1 X1 + \hat{b}_2 X2 + \cdots + \hat{b}_n Xn) \tag{3}$$

Taking the log of both sides of this equation, we can calculate the probability of a respondent being selected or not by each microfinance provider, as influenced by the explanatory variables.

IV. RESULTS AND ANALYSIS
4.1. Results
4.1.1. Microfinance Programmes of Zakat Institution
The case study institutions provide services with different levels of client coverage. Both BMMI and BAZNAS, as *zakat* organisations with national coverage, provide services across most parts of Indonesia. BMMI's microfinance programme is a mosque-based programme delivered through 185 mosques, in 28 cities and 21 provinces. This mosque-based microfinance programme includes 4,697

participants with total revolving funds of $US6.46 million and it employs 202 mentors. By contrast, the BAZNAS microfinance programmes were restricted to several areas of Jakarta, Depok, Tangerang, Bekasi and small areas in West and Central Java. The third institution, BMB, is a local institution in Yogjakarta, in the centre of Java Island, well known as a centre of Javanese culture. The institution has branches in 10 of Yogjakarta's 14 sub-districts and also in some sub-districts in Java. The major difference between BMMI and BAZNAS, and BMB, is the extent of their outreach coverage, which influences the ability of each institution to reach specific clients. *Zakat*-funded organisations that focus on wider national coverage may face logistical challenges in the communication and monitoring of their programmes compared to those in the BMB model that focus on the immediate local area.

The case study institutions shared a similar understanding that their outreach programmes are intended to provide financial services for the *mustahik*, or those who are eligible *zakat* recipients. Moreover, the programmes are designed specifically for the first two categories of *zakat* recipient: the poor and the needy. Prospective ICBM clients need to meet certain eligibility criteria in order to receive microfinance funding. Both BAZNAS and BMB use an assessment of clients' poverty levels as one of their key criteria. BAZNAS states that prospective clients must live on a maximum per capita income of $US2 per day. BMB does not set a threshold level on income; rather, they use the term *dhuafa* to identify the very poor in society in Indonesia. All of the case study institutions confirmed that they did not use gender as a criterion for determining clients' eligibility. The study data indicate a large proportion of female clients who have previously participated in or are currently participating in an institution's programme. The survey data show that 90% of BMB's clients are women.

In comparison to BAZNAS and BMB, BMMI expects prospective clients to meet more specific criteria. In the first instance, prospective BMMI clients must be active participants in their mosque and already be engaged in an existing microfinance enterprise. The clients' benevolent loan performance is evaluated not only on the basis of timely repayments but also on their participation in mosque activities. The eligibility criteria for prospective BAZNAS and BMB clients are more flexible compared to those of BMMI. The BMMI's specific selection requirements that prospective clients must actively participate in mosques and must have an existing business may unintentionally exclude poorer members of the community.

Along with differences in the eligibility criteria between the case study institutions, there are also differences in the client selection process. BAZNAS is the only institution that has a clear selection process. BAZNAS's application process begins with a survey of *zakat* recipients. In this process, clients who live in a sub-district of Jabodetabek (Jakarta, Bogor, Depok, Tangerang and Bekasi) are required to come to the main office of BAZNAS to present their business proposal along with their latest electricity bills and a letter from the village government confirming their financial hardship. Fieldworkers then visit clients in their homes to verify their living circumstances. The application process is more flexible for clients who live in other cities, with the verification processes conducted by telephone.

By contrast, BMB and BMMI use personal recommendations to select their clients. In this process, BMB identifies potential problems related to the availability of social assistance programmes in each of Yogjakarta's sub-district levels. This information is then used to select locations that have local business potential and that, to date, have received little in the way of government-funded social interventions. For example, BMB identified an area in which the local residents are highly experienced in quality pottery manufacture. As the residents have no access to funding to establish their own independent pottery enterprises, they generate income through their employment with a pottery company that pays minimal salary rates. After identifying a suitable location, BMB will contact local leaders to gather information about prospective clients and seek recommendations in relation to who may be eligible to receive microfinance funding. Similarly, BMMI relies on recommendations from the local branches of Bank Muamalat to select their clients. Bank Muamalat also takes responsibility for selecting a local mosque to be used as a venue for programme meetings and loan management activities. Bank Muamalat usually develops affiliations with local religious leaders and local MFIs for the purpose of locating prospective clients.

Interestingly, the interviews with the management staff and fieldworkers from BMMI and BAZNAS revealed that the process for locating clients is not that straightforward. A BAZNAS fieldworker noted that in Jakarta, it is difficult to find clients who are both really poor and who also meet the institution's eligibility criteria. Similarly, BMMI management staff identified inherent challenges in their attempts to design programmes that might attract potential clients. Given the high target set to distribute the funds within a given timeframe, BMMI currently does not expect prospective clients to meet specific poverty-related eligibility criteria, such as living under $US2 a day. The management is aware that this expectation may limit the extent of the programme's outreach to the poorest of the poor as the main target of the institution.

As prospective clients may live in rural areas with limited means of communication, institutions need to pay particular attention to how they effectively communicate the purpose, content, availability and eligibility criteria of their microfinance programmes. The data from the management staff interviews demonstrate that the programme communication strategies selected by each of the case study institutions vary. All of the case institutions use company websites to communicate their programmes and services and to make press releases and company reports publicly available. To increase public awareness of its programmes, BAZNAS regularly advertises them in the national newspaper, Republika. In addition, direct promotional strategies such as word of mouth are also used intensively. The staff of BAZNAS, as a principal ICBM institution, actively promote its programmes and recommend that prospective clients apply for a *qard hassan* loan from BAZNAS when they require funds to establish their own microenterprises. As subsidiaries of commercial financial institutions, BMB and BMMI communicate their programmes primarily via their main institutions, BMT Beringharjo and Bank Muamalat bank branches. Programme information is also communicated through written media as well as through direct promotion by customer service staff. In addition, BMB actively promote their programmes at the

village community and institutional level. The institution's social functions, *baitul maal*, can provide opportunities to promote the programmes to all stakeholders. For example, a village mass mentoring programme organised by clients is regularly conducted to celebrate BMB's anniversary. This particular programme promotional strategy has the potential to increase society's awareness of BMB's programmes and introduces clients, as BMB ambassadors, to society. A summary of each case institution's key outreach indicators, 'outreach coverage', 'client eligibility criteria' and 'communication strategies', is presented in Table 1.

Table 1.
Client Coverage, Criteria and Communication Strategies of The Case ICBMs

Key indicators	BMMI	BAZNAS	BMB
Coverage	185 mosques, 28 cities and 21 provinces	Jakarta, Depok, Tangerang, Bekasi, Bogor, West Java and Central Java	Yogyakarta
Eligibility criteria	*Mustahik*, active participants in their mosque and already engaged in a small business	*Mustahik* who live on under $US 2 per capita per day	Dhuafa
Programme communication Strategies	Websites Bank Muamalat branch network Local religious leaders	Website Word of mouth Newspapers	Website BMT Beringharjo branch network Institutional events
Client selection mechanism	Recommendations from Bank Muamalat	Business proposal, record of electricity bills, confirmation of financial hardship and a personal survey by-fieldworkers	Recommendations from local leaders and local community organisations

Source: Interview data from ICBM case study participants

4.1.2. Demographic Characteristics

The survey questionnaire was taken by four groups of respondents: one for each of the case study institutions (3 groups, 154 participants) and one group of non-clients (82 participants). Overall, most of the respondents were older than 45 years, had graduated from primary school and were members of small family households headed mostly by men. Table 1 contains several important findings related to the demographic profiles of the case study ICBM clients and the non-client group. Firstly, BMMI clients have a similar demographic profile to the non-client group. Secondly, BAZNAS clients are significantly older, have fewer years of formal education and have more women as the head of the family compared to the non-client group. Further, for BAZNAS and BMB clients, the findings show the significantly larger family sizes and more men as the head of the family, compared to the non-client group.

Table 2.
Demographic Profiles of The Case ICBM Clients and Non-clients

Family characteristics	Mean				
	Jakarta			Yogyakarta	
	BMMI	BAZNAS	Non-Clients	Baitul Maal Beringharjo (BMB)	Non-Client
Age of household head (years)	46.77	49.11**	45.6	47.36	49.28
Formal education Year level achieved (years)	7.8	7.48	8.23	9.04	8.46
Family size	4.3	4.75*	4.05	4.06**	3.24
Percentage of male household head (%)	83	73**	83	92**	78
Total	48	63	59	50	50

Source: survey questionnaires data, ** significant at 95% confidence level, * significant at 90% confidence level

The study compared the annual per capita income and monthly per capita food expenditure of both clients and non-clients. Overall, in Jakarta and Yogjakarta, the clients spent less of their income on food than the non-client group, although the difference may not be statistically significant. It was found that only BAZNAS clients spent statistically significantly less on food consumption compared to the non-client group.

Table 3.
Clients' and Non-clients' Monthly Food Expenditure

	Mean in rupiahs ($)				
	BMMI	BAZNAS	Non-clients Jakarta	Baitul Maal Beringharjo (BMB)	Non-clients Yogjakarta
Monthly per capita expenditure	260,998.02 ($1.32)	242,757.34** ($1.23)	327,536.37 ($1.66)	192,026.32 ($0.97)	204,093.03 ($1.03)

Source: survey questionnaire data, ** Significance at 95% confidence level

In addition, the study collected data on the clients' and non-clients' sources of household income, averaged over a 12-month period up to the time of the study to allow for seasonal fluctuations. The respondents were not asked to declare their initial income prior to joining their institution's programmes as their recall of this type of information may have been unreliable. The survey data for client income level is presented in Table 4.

In Jakarta, the study found that the average client per capita income was lower than that of the non-client group. By contrast, the average client per capita income in Yogjakarta was higher than that of the non-client group. This difference in the average per capita income between the client and non-client groups was only statistically significant for BAZNAS clients.

Table 4.
Clients' Income Levels

Variable	BMMI	BAZNAS	Non-clients Jakarta	BMB	Non-clients Yogjakarta
Annual per capita Income in rupiahs ($)	7,667,395 ($1166)	5,990,063 ($911)*	8,555,788.18 ($1301)	5,817,300 ($884.7)	5,468,979 ($831.7)

Source: survey questionnaire data, *significantly different to the non-clients' income at the 90% confidence level

Analysis of the clients' and non-clients' responses to the survey questions probing annual per capita income levels and monthly food expenditure exposed four key findings. Firstly, BMMI and BMB clients' monthly food expenditure is not significantly different from that of the non-client group. Secondly, BAZNAS clients spend significantly less on food compared to non-clients. Thirdly, the annual per capita income of BMMI and BMB clients is not significantly different from that of the non-client group. Lastly, the annual per capita income of BAZNAS clients is significantly less than that of the non-client group.

This study also measured the poverty level of clients and non-clients by comparing the respondents' expenditure on food to the US$2 benchmark set by the World Bank for a minimum standard of living. The data generated from the survey questions related to daily food expenditure show that the majority of clients and non-clients live below the poverty line. Interestingly, there are fewer non-clients living above the $2 per day benchmark than there are clients who live above it. This finding suggests that the non-clients have more vulnerable profiles than the clients in terms of poverty level based on food expenditure.

Table 5.
Poverty Level of the Clients and Non-clients

	Clients above the poverty line (%)	
	$0.95/day	$2/day
BMMI Clients	71	21
BAZNAS Clients	69	6
Non-Client Jakarta	78	31
BMB Client	40	4
Non-Clients Yogjakarta	55	6

Source: survey questionnaires data

4.1.3. Binomial Logit Model

In this section, the study uses binomial logit modelling to examine the characteristics of ICBM clients. The binomial logit model estimates the probability of a respondent being selected as a client of ICBM relative to not being selected using a range of explanatory variables including prospective client demographics, income and expenditure levels, business- and health-related problems and participation in social assistance programmes.

Table 6.
Binomial Logit Model Estimation Output

Characteristic	Variables	BMMI		BAZNAS		BMB	
		Coef P value	Prob (%)	Coef P value	Prob (%)	Coef P value	Prob (%)
	Intercept	-1.369 (.524)		-.440 (.824)		3.327	
Demographic	Age of household head	-.033 (.203)	49.16	-.023 (.335)	49.43	.009 (.727)	39
	Family size	.303 (.160)	57.52	.464 (.021)**	61.40	-.433 (.898)	49
	School period	-.078 (.261)	48.05	-.052 (.419)	48.70	-.058 (.403)	52
	Gender of HHH	-.068 (.924)	48.29	-.715 (.260)	32.85	.098* (.064)	47
Income and expenditure	Annual per capita income (in million rupiah)	.314 (.003)**	57.79	.255 (.011)**	56.34	-.138 (.155)	32
	Monthly per capita expenditure (in million rupiah)	-.503 (.804)	37.69	-.540 (.789)	36.82	-.755 (.300)	40
Personal concern	Limited business skills	.437 (.178)	60.75	.211 (.489)	55.26	-.416 (.986)	27
	Serious health condition	-.307 (.608)	42.39	-1.298 (.016)**	21.45	-1.013 (.143)	50
Participation in social assistance programme	Any other assistance	-.409 (.527)	39.90	.625 (.257)	65.14	-.014 (.771)	50

Source: estimation output, *significant at 90% confidence level, **significant at 95% confidence level

The results from the binomial logit model presented in Table 5 show that for BMMI, the selection criteria are solely influenced by income-related information, at the exclusion of any other information. Interestingly, the higher the prospective client's income level, the greater their probability of being selected. The rationale behind this possible selection outcome is that BMMI specifically requires prospective clients to have an existing business. This requirement may drive the institution to select a group with a higher income level for the programme.

In the case of BAZNAS, three variables are likely to significantly influence client selection: family size, annual per capita income and indications of health issues. The first significant variable in the model's estimation of the probability of being selected as a BAZNAS client is family size, the coefficient of which for BAZNAS clients is 0.464. Given that the other variables are constant, an increase in family size will increase the probability of being selected as a BAZNAS client by 61.4%. This estimated coefficient indicates that BAZNAS prefers to select clients with larger families.

The second significant variable to take into account is annual per capita income. The coefficient of this variable is 0.255, which means that an increase in a prospective client's income level by one million rupiahs will likely increase

their probability of being selected by 56.34%. This finding suggests that BAZNAS prefers to select clients at higher income levels.

Looking to the third significant variable, the incidence of health concerns is specified as a dummy variable, where '1' is assigned to clients who faced a serious health concern in the previous year and '0' is assigned to clients who did not face a serious health concern in the previous year. The modelled estimation shows that the coefficient of this variable is minus 1.298, meaning that if a client suffered a serious health condition in the year prior to them responding to the study survey, the dependent variable {log (p/1-p)} would decrease by minus 1.298, or alternatively that the probability of them being selected as a client who had suffered a serious health condition would increase by 21.45%.

For the last case study institution, the modelled estimate identifies that at the 95% confidence level, none of the study variables significantly influence the selection of clients for BMB programmes. When the confidence level is set at 90%, the modelled estimate shows that family size plays a part in estimating the probability of a respondent being selected relative to not being selected. The coefficient of family size is -0.433, which means that an increase in family size will reduce the independent variable log (p/1-p) by 0.433 and increase the probability of being selected by 49%.

4.2. Robustness test

The goodness of fit test aims to examine whether the overall constructed model is significant in terms of its ability to predict actual cases. Based on the chi-square values presented in Table 7, the model is statistically significant at 95% for BAZNAS and BMB and 90% for BMMI. The pseudo R-squared (Nagelkerke R Square) shows that the probability of being selected as a client in ICBM institutions can be explained by the explanatory variables to the extent of 8% in BMMI, 22.3% in BAZNAS and 16.2% in BMB.

Table 7.
Chi-square and pseudo R-squared

Y	Chi-square	-2 log likelihood	Nagelkerke R-square
Being selected in BMMI	13.396*	239.327	.080
Being selected in BAZNAS	43.224**	250.144	.223
Being selected in Baitul Maal Beringharjo	28.320**	230.429	.162

Further, the classification table presented in Table 8 answers the question of how accurate the constructed model is in terms of classifying individual cases. Based on this classification result, our constructed model is able to correctly classify around 80% of client selection in each ICBM case study institution. In other words, the classification results of this model are 80% according to the actual cases.

Table 8.
Classification Results

Observed		Predicted		Percentage Correct
		BAZNAS		
		.00	1.00	
BAZNAS	.00	199	8	96.1
	1.00	49	14	22.2
	Overall Percentage			78.9
		BMMI		
		.00	1.00	
BMMI	.00	221	1	99.5
	1.00	48	0	.0
	Overall Percentage			81.9
		Baitul Maal Beringharjo		
		.00	1.00	
Baitul Maal Beringharjo	.00	217	3	98.6
	1.00	49	1	2.0
	Overall Percentage			80.7

4.3. Analysis

In the context of ICBM institutions that benefit from Islamic funding resources, outreach is specifically defined as the capability of an institution to provide microfinance services to the poor and the poorest rather than to more financially secure clients. With the exception of BAZNAS clients, the descriptive analysis of demographic profiles shows that the clients and non-clients have a similar profile in relation to the age, formal education period and family size variables. Further, the survey findings suggest that, on their monthly food expenditure, the number of ICBM clients living above the poverty line is greater than that for the non-clients. The study's findings on the clients' poverty levels support arguments in the literature around the idea that microfinance is not suitable for the poorest of the poor (Robinson, 2001). However, this study's survey findings appear to contradict the Islamic microfinance literature in their suggestion that the extremely poor are well served by microfinance institutional programmes and services that are funded by Islamic charitable funding sources (Ahmed, 2002; Kaleem & Ahmed, 2009). This study found that contrary to their mission to reach out to the poorest of the poor, ICBM programmes are not effectively targeting eligible clients within the poorest demographic.

The findings derived from the binomial logit modelling indicate that only BAZNAS selects the most financially vulnerable as prospective clients. Meanwhile, BMMI was found to have selected clients who enjoy a marginally higher level of income compared to the non-client group. In the case of BMB, the gender of the household head is a key selection variable. Overall, this study found that BAZNAS appeared to be the only one of the three case ICBM institutions that targeted the more financially vulnerable in its client selection processes. These two key study findings raise interesting questions about the possible barriers that ICBM programmes will face in their efforts to more effectively reach out to eligible prospective clients.

There are several theories describing why the poor are excluded from microfinance. Exclusion may be the result of institutional lending policies as well as the poor's own decision-making (Simanowitz & Walter, 2002). Beck, Demirguc-Kunt, and Levine (2007) argue that the poor may choose to exclude themselves from accessing financial services for specific cultural or religious reasons, perhaps because of a lack of confidence and capability, or because they do not consider themselves to need such services. Cultural factors may constitute significant barriers to financial inclusion. Several studies have explored the importance of the need for MFIs to gain a greater understanding of culture in order to extend their outreach. For example, Shankar (2013) contends that cultural barriers arise from mistrust of banks due to individuals' negative experiences and perceptions or due to a lack of financial literacy. However, this assertion overlooks the values and cultures of the society itself. There are various specific values and norms in the society that can influence the poor's decision to participate or not in the financial market. The poor's own level of self-confidence and self-esteem, and how they see themselves in society, will also play into their decisions to access microfinance services, or not (Dhakal, 2004).

In addition to the poor who voluntarily exclude themselves from any participation in microfinance, a number of poor are involuntarily excluded due to structural issues. Potential clients' geographical remoteness, a lack of infrastructure, client eligibility and loan affordability have been identified as the major structural issues relevant to the poor's financial exclusion (Beck & Demirgüç-Kunt, 2008). Most frequently, structural barriers arise from the formal requirements set out by financial institutions for proper documentation for identification purposes, service fees and stipulated minimum account balances. Some institutions, for example, require prospective clients to have existing microenterprises before applying for a loan. These institutions unintentionally determine certain eligibility criteria that are not appropriate for the poorest's circumstances (Dhakal, 2004).

The study's findings highlight that the lack of participation by the poorer in BMMI due to the limited ability of that institution to reach out more expansively to them may be due to the exclusionary conditions within its client selection policies. Certain institutional requirements such as having an existing business may exclude the poor from participating in the programme. Simamowitz and Walter (2002) argue that it is almost impossible for poor individuals and families to have an existing business due to a lack of education, inadequate or inappropriate business skills and a fundamental lack, or absence of, working capital. A further example of a policy condition that is likely to be exclusionary in its impact on the poor's participation is the requirement for prospective clients to be actively engaged in the activities of their local mosque. Some poor individuals and groups may, for various reasons, hesitate to become more active mosque participants. A potential reason for this hesitancy is because the poor, compared to society's middle class, may never have had access to religious knowledge and training and therefore lack the confidence needed to take part in religious observation. Another reason is that the poor have limited time available due to work commitments. This argument was supported by the BMB management staff, who said that they do not target those who actively participate in their local mosque because many of the poorest, as their target clients, do not want to pray in mosques as they consider themselves

to be less knowledgeable with regard to how to perform the appropriate prayer movements. In the case of BMB, it is argued that the lack of participation of the poorest is due to policy-related concerns but rather to society's cultural norms and values, particularly those related to the marginalisation of the poor that inevitably leads to their self-exclusion from microfinance development programmes. In this sense, the poor put themselves out of the reach of ICBM institutions.

V. CONCLUSION AND RECOMMENDATION
5.1. Conclusion
This study presented a discussion on issues around the achievement of outreach as one of the key objectives in the effective management of ICBM institutional funds in Indonesia. Overall, the findings reported in this study highlight how the programmes of the selected case study ICBM institutions have been designed to provide opportunities for the poor to generate income through microenterprise development strategies.

The study's findings highlight a lack of participation by the poorer in the microfinance programmes of both BMMI and BMB. The lack of participation of the poor should be explained further in other qualitative studies. However, this study argues that the lack of participation of the poor in the ICBM programmes may be due to the barriers arising from institutional policies, combined with various cultural problems.

5.2. Recommendation
This research has produced several important recommendations for various parties, namely for ICBM institutions and for BAZNAS, as the regulator. For the ICBM institutions, in order for them to target the poorest groups of people, the conditions for selecting clients must be simplified. One example of this would be to not require clients to have a business already established. In addition, ICBM institutions should consider whether their programmes should be implemented in the mosque because some poor people still feel reluctant to go to the mosque due to their feelings of inferiority, such as feeling disobedient to worship and unfamiliar with the mosque.

This study also has important implications for BAZNAS as a regulator of zakat management in Indonesia. BAZNAS needs to produce guidance on how to use productive zakat, including the models and target clients that must be served. With this guidance, ICBM institutions can ensure that the implementation of zakat and microfinance programmes can be in accordance with sharia principles and community needs.

However, the study also has potential limitations concerning selection bias due to the limited sample used. Therefore, in the future, other studies in this field may include larger sample sizes by collaborating with zakat institutions in conducting impact studies.

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