TUJISE Turkish Journal of Islamic Economics

A Study on the Sustainability of Microfinance Institutions in Serving the Low-Income Group in Malaysia

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Abstract: A microfinance scheme was introduced in Malaysia in the year 1987 as one of the alternatives to poverty eradication strategies in the country by the government. Since then, several institutions have created to carry out the agenda of providing small loans to the low-income group to start up their small-scale business to generate more sources of income to support their household consumption. However, for a certain reason, the people still do not find microfinance an important tool to uplift their economic positions. Most of the low-income groups are still unaware of this golden opportunity tailored for them. Besides, the sustainability of these subsidized microfinance systems implemented by Malaysia had not been appropriately studied. This study explores the attractiveness of the products offered by microfinance institutions and emphasizes the option that the participants must start utilizing the product. This research also explores microfinance facilities that contain conventional finance element which is prohibited in Islamic trade. The study also discusses the measures and actions taken by microfinance institutions in serving the low-income group in Malaysia. This paper employs a qualitative method through interviews and content analysis. The report, journal publications, and other related documents were also analyzed in achieving the objectives. The study provides the impact that it may pave the way to an indistinct understanding of how Islamic microfinance institutions sustain their operations.

Keywords: Microfinance, sustainability, low-income group

JEL Classification: 016

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DOI: 10.26414/A2374
TUJISE, 8(Special Issue), 2021, 339-353
tujise.org

Submitted: 14.03.2021
Revised: 11.05.2021
Accepted: 21.05.2021
Published: 15.06.2021

Introduction

Malaysia is blessed with a diverse population of 50.1% ethnic Malays, 22.6% Chinese and 6.7% Indians, 11.8% indigenous Bumiputra groups other than the Malays, 0.7% other ethnic groups, and 8.2% non-citizens. The country's population is separated into two different regions, Peninsular Malaysia, and East Malaysia. Malaysia can be considered one of the most economically prosperous countries in Southeast Asia (SEA) and has successfully shifted from an economy mainly dependent on agriculture and natural resources to the rapid growth of manufacturing and services sectors.

There is nothing new in microfinance and its relation to small business traders in Malaysia. There are many interests and attempts by the people in the hope of becoming a micro-entrepreneur to enhance their incomes in several sectors and industries such as trading, farming, etc. In venturing into those kinds of business activities, many of them have problem with lack of capital to sustain their ongoing businesses or to use as a start-up for the cost of operation for their business whereas relying on banks or other conventional financial institutions to support their action by giving credits is difficult. The role of the bank as a financial entity to improve the economy in a particular segment and the living standards of the people in general stems from a point where it provides a platform for deposits, savings, loans, and other financial activities but most of them still not in favor of micro-financing or microcredit.

The main reason this paper focuses on the low-income group and relates with the use of microfinance to uplift their economic positions is that they are the ones that are struggling the most to achieve socioeconomic health and education equalities. The current situation shows that Malaysia is no longer just scuffling with absolute poverty but also pockets of persistent poverty, relative poverty, traditional rural and urban poverty, and other increasing economic inequalities. Between 2016 and 2020, over 2.6 million households were in the bottom 40th percentile of income-earner (B40). The average monthly disposable household income of the B40 group is only RM 2,500 and below. This amount of income restricts them from receiving a quality life or a decent living condition. They are the low-income group that is the focus of this paper. This group's issues and problems fuelled the effort in seeking a permanent solution in the said area through microfinance.

Microfinance institutions (MFIs) and Islamic MFIs (IMFIs) performance indications are not practically stable. It is often claimed that the institutions have limited funds available depending on the government allocation in the annual budget while they are burdened with high administration costs. In this regard, MFIs and IMFIs are mostly dependent on government grants and donations such as from the Baitulmal. There is a need for even larger funding, especially in the early stage of the institutions' establishment, because it takes longer for MFIS and IMFIs to operate using their income generated from capital repayment and savings.

The study explores the services and products offered by the microfinance institutions and Islamic microfinance institutions that are available to the low-income group in Malaysia. It also studies the level of attractiveness of the MFI products among the low-income group in Malaysia and identifies the funding amount successfully channelled to the participant. The paper aims to determine the effectiveness of the funding provided by microfinance institutions to the low-income group in Malaysia.

Literature Review

In the modern era, microfinance has been recognized worldwide as a developmental tool to assist the unbanked segment of society to reduce poverty and increase participants' income. Masyita & Ahmed (2013), in their article, defined microfinance institutions as a "social enterprise" that carries the primary mission to improve the livelihood of the poor by providing financial services for them to conduct small-time business activities. According to Adongo & Stork (2006) in their article 'The microfinance gap: Selected issues for Namibia', the microfinance sector is a competitive, dynamic, and complex industry, which channels its funding to aid the poor grow sustainably. As part of the financial sector, the microfinance institutions provide financing not only to the economically poor and low-income households but also to small and medium enterprises (SMEs) that already established their business foundation (Kamukama et al., 2010).

However, in some events, MFIs fail to deliver their main objective and purpose to serve the low-income groups due to internal problems and financial constraints (Tuyon & Ahmad, 2016). Early research has warned market players comprising of domestic and international investors, academicians, creditors, and policymakers of this circumstance. Gutiérrez Nieto & Serrano Cinca (2007) reported that nearly 97% of MFIs studied have shown negative net income and are not financially self-sufficient. Donors and government bodies subsidize most MFIs operations. Although microfinance has an increasing demand in the Malaysian market, microfinance institutions in this country struggle with issues that affect their sustainability. These issues have bad implications on outreach programs structured by the institutions (Kazemian et al., 2016). Malaysian MFIs however are not performing well despite the report from World Bank (2018) that MFIs in Asian countries are showing progress better compared to Eastern Europe. In this matter, Malaysian MFIs are inefficient when it comes to self-reliance as they are wholly dependent on funding from government grants, local financiers, and donations. Adejoke (2005) added that Malaysia is among the countries that have unsustainable MFIs compared to other countries in the Asian region. MFIs can be considered as being self-sufficient once they can cover their overhead cost, operating costs, paying fix salary to the employees, and generate continuous profits, without relying on funding from other entities and at the same time able to increase the number of participants by reaching more people to partake in the scheme (Chan & Ghani, 2011). Some MFIs rely on external funding during the early phase of their establishment but can reduce external dependence in times when transactions are revolving. This cycle is efficient enough to serve the institutional purpose (Bakar et al., 2019).

Comparison Between Microfinance Institution and Commercial Bank

MFIs deviate from standard financial institutions as they usually operate in developing countries. Their main objective and role are to give financing access to the needy borrowers without collateral. Some MFIs are not allowed to collect deposits, whereby they frequently receive contributions from governmental agencies, Baitul maal wat tamwil (BMT) or NGOs to proceed with their social mission (Dorfleitner et al., 2013). Table 1 shows the different features between commercial banks and MFIs.

Table 1.
Comparison between commercial banks and microfinance institutions

COMMERCIAL BANK	MICROFINANCE INSTITUTION
Capital and interest are normally paid as the contract matures	Capital and interests are paid in the form of weekly/monthly instalments annually.
Amount of loan is high.	Amount of loan is low.
Clients apply for funding from the banks	MFIs reach out and find people in need of funding
Clients are financially wealthy	Clients are financially underprivileged
Clients need to put forward physical collaterals to obtain funds	Clients need to be involved in groups as social collateral.
Exclude social/educational programs	Comprises of social/educational program
Act as financial intermediaries between the client and financiers.	Receive funding from external sources to provide microcredits for the underprivileged group.
Focus on gaining profits	Focus on improving the socio-economy of the low-income people.

Source: Bank Negara Malaysia (2007)

MFIs are considered risk-taking, non-profit organizations, while commercial banks are profit-oriented and risk-averse. Furthermore, funding for MFIs comes in the form of government grants and donation, while commercial banks depend on the depositors and investors. Commercial banks receive clients' deposits as their liability account while MFIs accept deposits monthly from the creditor. Furthermore, MFIs are often involved in educational, healthcare awareness, and other social programs, while commercial banks are often not participating in these types of social engagements.

Types of Microfinance Institutions

Over the past decades, the microfinance industry has grown and shown rapid progress at a remarkable pace. Even though microfinance started and is usually practised in developing countries, it has started getting popular in developed countries (Sim & Prabhu, 2014). Primary players in the microfinance industry can be broken down into three groups which are the formal sector, semi-formal sector, and the informal sector (Sim & Prabhu, 2014). Each sector carries out its objective.

Formal Sector

According to Churchill & Frankiewicz (2006), formal financial institutions are subject not only to general laws but also to specific regulation and governed by the Central Bank, Ministry of Finance and any related agency involved. According to the Bank Negara Malaysia, there are five commercial banks and five development banks that associate directly with the growth of microfinance sectors in Malaysia. The commercial banks are CIMB Bank Berhad formerly known as Bumiputra-Commerce Holdings Berhad, Maybank Berhad, AmBank Berhad, Public Bank Berhad and Bank Muamalat Malaysia Berhad. The Development Financial Institutions (DFIs) or development banks involved are Agrobank Berhad, Bank Kerjasama Rakyat Berhad, and Bank Simpanan Nasional (BSN), Bank Pembangunan Malaysia Berhad and Small Medium Enterprise Development Bank Malaysia Berhad (SME Bank). In terms of capacity and engagement building, the DFIs usually provide consultation services to their clients. Thus, the social logic seems to be the success factor of their microfinance programs (Nabiha et al., 2018).

Semi-formal Sector

The number of Malaysian semi-formal MFIs have progressively grown from year to year as more participants took part in the scheme (Al-Shami et al.,2016). The Malaysian microcredit system started with the formation of Majlis Amanah Rakyat (MARA), a Malaysian government agency, in 1966. Hence, in 1987, Malaysia established its own version of the Grameen Bank to provide a similar business model. It leads to the introduction of Amanah Ikhtiar Malaysia (AIM), which is a non-government organization. The other non-government MFIs are Economic Fund for National Entrepreneurs Group (TEKUN), Credit Guarantee Corporation (CGC), and Yayasan Usaha Maju (YUM).

Framework of MFIs in Malaysia

Microcredit in Malaysia has existed since the revolution of the New Economic Policy, which was implemented in 1970 under the then Prime Minister, Tun Abdul Razak Hussein. The New Economic Policy was a social affirmative action program created by the National Operations Council (NOC) after the tragic event of the racial riot on the 13th of May 1969. The first phase of the Policy was adopted in 1971 for 20 years, and it was succeeded by the National Development Policy (NDP) in 1991 (NDP, 2015).

The NEP was conceived to carry out two missions that are to eliminate poverty for all Malaysians and subsequently to erase identification of race by economic function and geographical location. The Policy trying to achieve its main objectives through an immediate expansion of the economy over time and set its primary target of effectively reducing absolute poverty by the year 1990. To make this possible, the Policy called for a dynamic improvement of economic status and quality of life for all citizens through access to land, entrepreneurial training, and improvement of public facilities. Issues were arising from state interventions like quotas that disrupt market volatility had reduced growth and led the country into a recession in the mid-1980s, which initiated the restoration role of the private sector (Thillainathan & Cheong, 2016).

The NEP had the core mission to execute economic restructuring to eliminate the identification of ethnicity with economic function. The first target was to improve the ratio of economic ownership in Malaysia from 2.4:33:63 ratios of Bumiputra (Native Citizen), other races, and foreigner ownership to 30:40:30 ratios. This was to be done by strategically redistributing the national wealth by increasing the ownership of business and enterprise owned by Bumiputras from the then 2.4% to 30% of the share of total national wealth.

The credit unions, specialized credit institutions, co-operatives, and non-government organizations (NGOs) were among the first institutions to uphold the microcredit initiative. Small loans were provided to the small enterprises and agriculture sector to reduce poverty and improve the Bumiputras' economic position. Some of the Malaysian microfinance regulations include the Cooperatives Societies Act 1993, (Moneylander Act 2002), BAFIA 1989, which later be improvised and replaced by FSA/IFSA 2013, and the Development Financial Institution Act 2002.

MARA and CGC were among the earliest institutions to begin the microcredit access to the low-income group in Malaysia. There are several other rural credit institutions and government bodies that provided financing mainly for agricultural sectors, such as Federal Land Development Authority (FELDA), Rubber Industry Smallholders Development Authority (RISDA), Agrobank Berhad, and Farmers Organization Authority (FOA). Furthermore, financing access is also provided by NGOs, including AIM, YUM, Koperasi Kredit Rakyat (KKR) in Selangor, and Sabah Credit Corporation (SCC). The government agency is known as Tabung Ekonomi Kumpulan Usaha Niaga (TEKUN) also done its part in this microcredit scheme. In the case of AIM, almost 99% of the members are female entrepreneurs, and the loans are provided generally on a short-term basis for a period between 25 and 150 weeks to repay the loan (Duasa & Zainal, 2020).

Comparison of Islamic Microfinance and Conventional Microfinance

Although most people in Malaysia are Muslims, not all microfinance institutions adhere to the Shariah principles. Even though the concept of Islamic microfinance differs from the conventional, but there is a concern that whether, in reality, the operation of Islamic microfinance is different from conventional microfinance or otherwise (Abdullah et al.,2017). Table 2 below shows the differences between Islamic microfinance and conventional microfinance.

Table 2.

Differences between Conventional and Islamic Microfinance

Description	Conventional MFI	Islamic MFI
Aims of Social Development program	Un-Islamic (secular), behavioral, social development and ethical	Religious growth (includes behavior, ethics and social)
Ways to deal with Default	Threats/ group/center Pressures.	Islamic ethics, guarantee by group/center/spouse
Work incentive of employees	Monetary	Monetary and religious
Loan liability	Recipient and spouse	Recipient only
Objective for loan provision for women	Women empowerment	Increasing access to loan
Target Group	Women	Low-income Family
Fund deduction at the start of a contract	Some of the funds are deducted at the start of a contract	Participants will receive the full amount of the fund as there is no fund deducted.
Fund transfer	Cash given	Cash & Goods transferred
Provision of funding to the poor.	Provision of fund to the poor is not prioritized.	Prioritize funding to the poor through combining microfinancing with zakat
Mode of Financing/Assets	Based on interest	Adopts Islamic Financial system.
Funding source/Liabilities	Clients' savings, External Funding	Clients' savings, External funding, Islamic Charities

Source: Ahmed (2002)

Identifying the Research Gap

Based on the review of literature on the topic, there is a great demand for a new approach on how the sustainability of microfinance institutions is being managed and the position of MFIs in the financial framework in Malaysia. While many researchers have studied in this area within different institutions and sectors on how microfinance works at its best in poverty elevation, only a few have dealt with the institution's sustainability in handing out financing to the targeted group. As discussed by Dusuki (2008), sources of funding and government support need to be improved to determine the effectiveness and sustainability of MFIs performance. However, most of the previous empirical studies looked into those factors separately. The sustainability of MFIs and government support have not been explored extensively, especially in this country. Therefore, the research gaps are summarized as below:

1. The sustainability of the formal financial sector is explored extensively in large organizations but not in MFIs.

2. Limited research on human resource competency as a middle role in the relationship between knowledge, structural capital, and microfinance performance.

3. Collaboration with a government agency as support to widen geographical location to improve microfinance performance.

The research gaps show the need for a new standard operating procedure and a transparent framework for a microfinance institution in Malaysia to improve the sustainability of this institution.

Data and Methodology

Throughout this study, primary data was used, which may assist in discovering the views of the industry expert who has strong knowledge related to this subject. This study is detailed in its feature, and thus, it seeks to acquire only the opinion of experts and specialists who are directly involved in the microfinance industry. A face-to-face interview is more relevant to this study as compared to other data gathering methods. Sekaran (2003) indicated that the option of data collection methods depends on the tools available, the intensity of preciseness required, the competency of the researcher, the duration of the study, and other factors such as accessible material available for data gathering. In finishing this paper, the researchers rely on information and data from several channels: primary and secondary sources of data.

The researchers also obtain information from some secondary sources of data such as academic articles, published documents, financial reports, product brochures, websites, and other related sources in giving additional information and clarification. This is due to the materials that are available on secondary data are reliable and quite accurate. The researchers collect data from company history profiles, published journals, and related literature reviews.

Every study conducted by a researcher would require a reliable data source for the authenticity of the outcome. For this study, face to face interviews were carried out for two institutions comprising five informants who are working with the MFIs, three individuals from Institution A and two from Institution B. Interviewees need to be open and transparent in the session and they need to be comfortable about the questions given to them by the researcher so they can speak freely without disturbing business protocols and breaking company policy.

The researchers decided to adopt a semi-structured interview session by letting the interviewee speak freely about the issue in microfinance institutions and asking specific pre-determined questions. A semi-structured approach that was used would enable the interviewee to speak freely, at the same time allowing the researcher to make sure certain issues were covered and answered. During the interview session, the researchers have a checklist to record answers. Table 3 below shows the list of informants' information from two institutions with their position and department for the study. Most of the informants have more than five years of working experience in this field.

Table 3.
Informants' information

Informant	Institution	Position and Department
Informant A	Institution A	Deputy Head of Section in Business Financing Division
Informant B	Institution A	Senior Officer in Business Financing Division
Informant C	Institution A	Officer in Business Development Division
Informant D	Institution B	Director in Business Financing Department
Informant E	Institution B	Senior Officer in Business Financing Department

From the information obtained by the researcher, a general overview of the sustainability of the MFIs and operation practices in Malaysia is made. Through content analysis, all information from both institutions was put together and compared to discover similarities and differences between them. Careful attention is paid to observe any change of trends within both institutions that offered microfinance products. Other than that, the document and reports obtained were thoroughly examined before being extracted to preserve the authenticity and ensure it is relevant to the study.

Finding and Discussion

From the responses of interviewees from Institution A, the findings can be summarized as follows: Qardhul Hasan, Bay Al Inah, and Mudarabah are the type of Islamic contracts used by this institution in its business financing. For example, microfinancing in the Youth Financing Scheme with the amount not exceeding RM10,000.00 only requires the borrower or participant to pay the principal amount of the financing without any interest or profit charged. This shows the institution's commitment to uphold Islamic values and good deeds towards the development of the low-income group in Malaysia. Institution A does not have a Shariah division in endorsing all Islamic financing contracts offered; however, it takes the initiative to form a strategic partnership with a local Islamic bank in using their expertise to advise them regarding this matter. One of the banks is Bank Kerjasama Rakyat Malaysia.

For the microfinancing scheme provided by Institution A amounting below RM10,000.00, a strict credit assessment does not apply since most of the participants who apply for the financing have never had experience in conducting business. If the applicant of the loan fits the requirement given by the institution, they are entitled to get the financing. There was no strict regulation to help the poor and low-income groups towards the betterment of their economic passion, unlike commonly practised by the conventional financial institutions. Furthermore, the microfinance product offered by Institution A does not require collateral or a guarantor. The performance of the participant is assessed through the repayment of the principal financing according to a pre-agreed repayment schedule. If any participant suffers difficulties in managing their business and has a hard time in paying back their financing, it will offer payment restructuring accordingly and provide business consultation in giving solution to whatever problem is faced by the borrower.

The financing range for microfinance schemes is up to RM10,000.00. However, there are more financing schemes and products offered by Institution A that could reach up to RM1,000,000.00 financing amount. Product disclosure briefing session is held before the contract signing takes place, subject to the approval of the financing applied. It is one of the government bodies that have a specific reason for its establishment. The sustainability of this institution depends solely on the funding from the government under the budget of the Ministry of Rural and Regional Development. Thus, it is not considered a profit-oriented institution. On the other hand, the Policy and code of conduct might be different from its subsidiaries, where the sustainability of the company depend on the profit generated from the services and products offered by the company.

While Institution B only has one purpose, which is to focus on the national entrepreneurial development among the low-income group in Malaysia. Since its establishment in 1998, it undergoes several changes of approach in Policy, operation, and structural standard. This institution was put under the Ministry of Entrepreneurial and Cooperative Development to provide small and easy financing facilities to the entitled participant to start their business venture, improve their economic position, and increase household sources of income. For the past decade, the institution has undergone several changes and reforms to fit the current flows in becoming a dynamic entrepreneur development entity rather than just being a financing house. Now the institution has become the number one platform that provides business opportunities, income-generating opportunities as well as a business advisory hub in linking up networking platforms to businesses and individuals. The game-changer in the practice of this institution is where the service that they offer were being diversified. Before, it only provided products related to microfinance and small loan as business financing. Now it also has its gold pawn services, Ar-Rahnu. However, this service only available in select states and areas, and microfinance is still the number one propriety among the products.

The main feature used by the institution in its financing contracts is Tawarruq. However, several other Islamic contracts are used, such as Qardhul Hasan, Wakalah, Ta'widh, Gharamah, and Ibra. The most common microfinancing scheme offered by the institution is Skim Pinjaman Mikro (Micro financing Scheme); the amount of financing in this category is between RM1000 to RM5000 where the borrower or participant of the scheme only requires to pay the principal amount of the financing. This shows the commitment of the institution in upholding Islamic values and good deeds towards the development of the low-income group in Malaysia.

Under the micro-financing scheme (SPM), strict credit assessment does not apply since most of the applicant who applies for the financing scheme has never had experience in conducting business. If the applicant of the loan fits the requirement given by the institution, they are most likely entitled to get the financing. Unlike commonly practised by the conventional financial institution, there was no strict regulation in helping the poor and low-income groups in making a difference towards the betterment of their economic status. Furthermore, for microfinance product offered by Institution B does not require collateral or guarantor. The performance of the participant is assessed through the repayment of the principal financing according to a pre-agreed repayment schedule. If any participant suffers difficulties in managing their business and has a hard time in paying back their financing, it will offer payment restructuring accordingly and provide business consultation in giving solution to whatever problem is faced by the borrower.

The financing range for microfinance schemes is up to RM5,000.00. However, there are other financing schemes and products offered by Institution B that could reach up to the RM50,000.00 financing limit. The successful applicant needs to undergo a compulsory business fundamental class of two days conducted by the institution's human capital. This is an initiative to sharpen basic business knowledge of the borrower and to hold a product disclosure session to make sure all applicants know the terms and conditions of the financing imposed. The sustainability of this institution depends solely on the funding from the government under the Ministry of Entrepreneurial and Cooperative Development.

Conclusion and Recommendation

Based on the findings, microfinance institutions have different types of procedures in providing financing to the targeted group. For Institution A, the targets group are the youth from low-income families who are eligible to apply for the microfinance scheme, whereas the eligibility for Institution B is more open for all low-income groups consisting of no racial barrier and age. Furthermore, the contracts that were used by both institutions are most likely to be the same, but for Institution A, according to one of the officers, aqad that has been widely used in microfinancing products is mudharabah, although there are other types of aqad provided by the institutions.

The level of attractiveness of the microfinance product offered to the low-income group in Malaysia and the amount of funding successfully channelled to a participant by both the institutions are also determined by the number of its participants throughout the years. In addition, most of the customers who took financing with Institution A tend to have more knowledge and higher education background because part of the condition for financing to be approved is that they prefer to offer the services to graduates from the institution subsidiaries college or university. However, for Institution B, there is no such condition towards the applicant, and the chances of getting financing are only to fulfil the minimum requirement as stated in a result of the interview. For the sustainability of both institutions in maintaining funding sustainability, it is indisputable that they still wholly depend on the government's grant and allocation that is announced each year in the national budget specifically naming the institutions and the purpose for the allocation of funds.

This research may pave the way to a clearer implication towards how an institution operates and sustain its operations. This study represents a part of advancement from the previous study to evaluate microfinance in Malaysia, particularly in terms of the research approach adopted. For instance, the construction of the questions put forward to the interviewee gives a fruitful idea to the researcher in how the evolution process of microfinance took place and how it overcomes an obstacle to guarantee its survival up to this day. Most studies used only one source of information collected to be analyzed, but this study goes a mile further and demonstrates that a holistic approach is suitable for investigating microfinance interventions. For example, the information gathered among the institutions and how much funding received by the respective institutions from the government's grant allocation and how much funding comes from sources other than that.

The scope of this research is only limited to microfinancing products and services that are directly available in Islamic microfinance schemes provided by formal, semi-formal financial institutions in Malaysia. The researchers conducted interviews only for two microfinance institutions to gain information regarding the microfinance program that they are offering despite there being many other institutions that offer microfinance schemes. Instead of obtaining information regarding customers' financial position, awareness, and household income before and after their involvement in the microfinance program, this research focuses on the sustainability of the microfinance institutions in channelling out funding to finance the microfinance program to the targeted group. This states all the factors based on Shariah's perspective, financing system, and the services that improve a participant's financial wellbeing and awareness toward MFIs.

The study provides more ideas about both institutions in offering microfinance products to participants regarding ways around the process. In terms of the services, researchers hope that in the future, both institutions can establish a proper credit valuation, business competency screening process of the participants so that only the productive un-bankable individuals are shortlisted to receive the financing. Although this sounds more like the philosophy of capitalism, all parties need to see the bigger picture of having a long-term sustainable finance house that benefits society. With limited resources and low financing repayment rates, and the institution facing severe debt collection management issues, this may not be a good benchmark for the future.

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