Chapter 14

Baitul Maal wat-Tamwil
Services for SMEs: Evidence From Indonesia

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ABSTRACT

This chapter investigates the relationship between service quality of Baitul Maal wat-Tamwil (BMT) and the satisfaction of small and micro-enterprises in Indonesia with perceived benefits as the mediating variable. Primary data is collected from 454 small and micro-enterprises located in the western part of Jawa Island of Indonesia and the CARTER model is adopted to test the satisfaction of small and micro-enterprises upon the services provided by their patronized BMT as Islamic microfinance institutions. By using the structural equation model, the finding confirms that perceived benefits fully mediate the relationship between service quality of BMT and small and micro-enterprises’ satisfaction.

INTRODUCTION

Today, access to financing for small and micro-enterprises is believed as one of the most significant tools to narrow the income distribution gap among the people and to alleviate poverty. It is a new initiative which is acclaimed to bring a new paradigm of economic development which is not only focusing on growth but also on equality and quality of the development.
In the last thirty years, thousands of small and micro-enterprises (SMEs) were established in Indonesia. However, after the 1997-1998 global financial crisis that hit Indonesia severely, most SMEs were closed down due to financial problems. Commercial banks could not provide loan and save them because the transaction cost of the credit and the probability to default are considerably high. Therefore, a good and sustainable strategy is needed in order to help them survive and eventually improve their performance (Rafay, Franco & Gilani, 2019). One of which is by providing them accessible financial services.

Islamic microfinance institution is part of the Indonesian microfinance system since 1990, when the first Islamic cooperatives or Baitul Maal wat-Tamwil (BMT) was established. It was to provide Muslim SME owners with Shari’ah compliant financial products and services. Another benefit of using services from Islamic microfinance institutions (IMFIs) is that they can provide financial services that can be tailored with the condition and needs of poorer communities. The IMFIs can provide financial services similar to commercial banks such as credit and savings but in micro-scale transactions. For that reasons, IMFIs is considered more inclusive than the conventional one. The inclusivity of IMFIs gives an opportunity to create the basic conditions for sustainable and successful SMEs.

Mutual cooperation and solidarity are two elements known for strengths of IMFIs which had increased the need of establishment and demand for Shari’ah compliance products and services from IMFIs. It is also the aspirations of Muslim entrepreneurs today to look for funds that is free from usurious transactions. Despite the fact that most of the IMFIs are informal institutions, interestingly the demand for the Islamic microfinance services is reported very high in developing countries like Indonesia and Pakistan (Masyita & Ahmed, 2011). Furthermore, the CGAP reported that in 2011, as many as 72% people who live in Muslim countries are not able to use services from formal financial institutions in fulfilling their needs. Therefore, the existence of IMFIs is very helpful for them, especially the lower income group.

Although IMFIs offer many advantages to SMEs, there still a lot of serious barriers in the market such as high transaction cost charged by almost all of IMFIs in Indonesia (Masyita and Ahmed, 2011). This condition is actually because IMFIs need more funds to do the monitoring, administrating, and collecting the payment while the number of their customers are less than expected. Other problems occurring in IMFIs are the higher level of credit risk compared to conventional microfinance institutions, moral hazard, culture, and the absence of physical collateral. Thus, IMFIs always try to mitigate these risks by minimizing their operational costs and transfer it to the other side of the book.

However, despite the fact that IMFIs offer SMEs high transaction costs, the cost is still below the cost demanded by banks. This is the reason why the number of IMFIs in Indonesia is still growing until now. Table 1 below shows the development of IMFIs in Indonesia from 1990 to 2018, particularly the BMT.

With the big number of BMT and other Islamic financial institutions in Indonesia, BMT have to compete with not only other IMFIs but also with other financial institutions e.g. Islamic and conventional banks, leasing companies, cooperatives and so on since this industry comprises a large number players. In this competitive market, it is vital for the BMT to enhance the quality of services in order to expand their business through sustaining the existing customers and capturing more new ones.

The services offered by BMT would be perceived by customers as a serious effort in achieving the value of Islamic teaching which is to free the society from Riba. This positive perception of BMTs’ services by the customers plays an important role in augmenting their satisfaction if the quality of the services provided by the BMTs can meet their expectations.

In a free competition market, all players formulate the unique and different strategies for winning the competition and retain the market, but all strategies could not be effective without increasing the quality of their services. The quality of services provided is the key factor for success in business and will