

# Finding a Way to Enhance Impact of Islamic Microfinance: The Role of Spiritual and Religious Enhancement Programmes

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## Abstract

This study assesses impact of Islamic microfinance and look for possible factors that may strengthen impact of this *Shari'ah* compliant microfinancing service. For this purpose, it explores possible impact that can be delivered by spiritual and religious capacity building that Islamic microfinance can provide to their clients. To achieve this objective, this study distributed survey to 400 Muslim microentrepreneurs who mostly received Islamic microfinancing. The findings of this study found Islamic microfinance initially able to provide positive impact on their clients with some limitations. In addition, this study also found that higher spirituality level in general able to bring more wealth, while having higher religiosity may enhance clients' economic performance. These findings implicate that both spiritual and religious enhancement programmes need to be adopted in capacity building provided by Islamic microfinance institutions to their clients. This study argues that the spiritual and religious enhancement programmes in short run is able to enhance positive impact of the Islamic microfinance on their clients.

**Keywords:** Islamic Microfinance, Impact, Poverty, Spirituality, Religiosity.

## 1. Background

Poverty is an unresolved problem for most developing countries, including Muslim-majority countries. The World Bank in 2007 expected there were 880 million people living under extreme poverty level or with less than US\$1 a day, while, 2.1 billion people were living under moderate poverty level or with less than US\$2 a day.

Since the last two decades, microfinance, the provision of financial services to poor or low income clients, including consumers and the self-employed has been regarded as a prominent effort in alleviating poverty (Afrane, 2002). Microfinance works by providing financial schemes or financial services in the form of savings and credit opportunities to the working poor (Ledgerwood, 2001).

The success of microfinance institutions (MFIs) in alleviating poverty has supported the development of faith-based microfinance institutions including Islamic MFIs. This mode of MFIs provides interest-free financial services that are compliant with the *Shariah* or Islamic law. These institutions also integrate Islamic social charitable funds such as *zakat*, and *waqf* as their sources of fund. This enables the Islamic MFIs to distribute funds to the poor community (Obaidullah, 2008; Ahmed, 2002).

Based on the distinctive characteristics of the Islamic MFIs, Ahmed (2002) argues that Islamic MFIs can perform better compared to the conventional ones. He argues that the Islamic teachings provided to the Islamic microfinance institutions improve solidarity and social capital among the clients. This allows them to be better debtors since repayment is considered as a religious obligation.

In addition, the social capital derived from Islamic values and principles positively influences the employees of Islamic MFIs, as it provides them the additional incentive to strive for the betterment of the lives of the poor. As a result, the improvement in the profitability and viability of Islamic MFIs are ensured. That is, Islamic social capital increases the productivity of employees (thus reducing costs), and at the same time, it reduces the default rate of the clients (Ahmed, 2002).

Despite these claims, to date, there only few impact assessment study that scientifically proved the impact of Islamic microfinance on their clients. Moreover, to the extent of researcher knowledge, it is almost rare to find study that proves specific characteristics of Islamic microfinance able to provide additional impact on microfinance objectives, particularly on poverty alleviation.

In practice, there are many Islamic MFI, especially in Indonesia, that provide spiritual and religious capacity building programme for their clients. However, there is shortage of study that seek evidence on how this specific Islamic microfinance characteristic able to enhance impact of Islamic microfinancing. Interestingly, there is an argument that spiritual commitment combined with practical support can be more effective in improving the lives of the poor than mere technical help can do (Tripp, 1999). Due to this circumstance, this study aim to make a reference on the possible influence of clients' spirituality and religiosity in assessing the impact of Islamic microfinancing on their clients.

## 2. Literature Review

To achieve the objective of this study, this study review literatures on impact assessment of Islamic microfinance, and literatures on spirituality and religiosity. The discussions are deliberated in these following sub sections.

### 2.1. *Impact Assessment of Microfinance*

A number of microfinance impact assessment studies have been conducted in various countries. Among the pioneer of impact assessment study is the study conducted by Hossain (1988) in Bangladesh. This study found microfinance services made positive contributions to the alleviation of poverty and improvement in living standard of the clients. The result of this study is confirmed by other studies such as those by Pitt and Khandker (1998) that assessed the impact of various MFIs also in Bangladesh.

The findings of Pitt and Khandker (1998) however, were challenged by Morduch (1998). By utilizing similar data as need in these two studies, Morduch (1998) claims that the potential impact of microfinance is associated with reduction of vulnerability, not poverty. He also criticizes the microfinance programmes by proving in his study the problem of mis-targeting the selection of clients. This is because 20-30 percent of microfinance clients are the better-off among the poor.

From a more positive outlook, Zaman (2000) supports the finding of Morduch (1998) by proving that microfinance services may reduce vulnerability. There are more studies that actually support the positive view of the impact of microfinance either on poverty or vulnerability. Among of these studies is the one conducted by Chowdhury et. al. (2005). This study found that microfinance services may provide positive impact toward poverty reduction, objectively and subjectively.

The positive impact of microfinance was also proven in Indonesia. Hulme and Mosley (1996) wrote a book on microfinance reporting their experience in assessing the performance of various MFIs around the globe, which include the MFIs in Indonesia. In their book, they provide a positive report on the MFIs in this country. Unfortunately, the latest article that assessed the impact of Indonesian MFIs done by Takahashi et. al., (2010) discovered that the impact of MFIs on poverty alleviation might not be an immediate impact. This finding is somewhat disappointing as MFIs are widely recognized as important tools for poverty reduction in this country. Specific for Islamic microfinance, a study conducted by Widyanto and Abdul Ghaffar Ismail (2006) found the size of financing and other demographic variables such as formal education, marital status and business experience have significant influence on the improvement of business asset, business income and improvement in productive assets. However, this study provides no information which specific characteristic of Islamic microfinance that able to provide additional impact on microfinance clients.

Other than Indonesia and Bangladesh, Microfinance impact assessment studies have been undertaken in various parts of the world. In Malaysia, Mahmud (2006), Saad and Duasa (2009) Al Mamun et, al. (2010), Al Mamun and Adaikalam (2011), Mokhtar (2011), as well as Hamdan et, al. (2012) found positive impact of microfinancing. However, more clients who work in agriculture found as having difficulties in repay back the loan (Mokhtar; 2011).

In Pakistan, the positive view toward microfinance impact assessment services is also found and justified. Montgomery (2005) found the MFIs have positive influence on income generating activities in the agricultural industry, especially for the poorest clients. The finding of this study is supported by Khan and Shirazi (2007). This study concludes that microfinance is able to reduce poverty and improve poverty status of the extremely poor borrowers, the ultra poor and the poor. However, this study found the status of the vulnerable group does not suggest any improvement.

Another positive insight about microfinance services is found in South Africa by Afrane (2002). Microfinance interventions authentically make significant improvements on the lives of their clients specifically in terms of increasing business incomes, improving access to life-enhancing facilities, and empowering of people, particularly women. Makina and Malabola (2004) who did the same study in South Africa also found the similar findings specifically in terms of women empowerment. Unfortunately, this study criticizes the microfinance services because they found that low-income communities in rural areas have benefited less than their not-so poor counterparts in the urban areas. This result actually is in line with the findings of Murdoch (1998) in Bangladesh.

Mixed results are found in the rest of Asian countries. Coleman (1999) in Northeast Thailand for example, found that the impact of group lending of microfinance is insignificant for most indicators such as physical assets, savings, production, sales, productive expenses, labour time, and most measures of expenditure on health care and education. It is negatively significant on expenditure for men's health care but positively significant on women's high-interest debt. Differently, Todd (2000) found positive impact of microfinance services in the Philippines. The result of this study found reduction on the number of clients who live in poverty after participation in MFIs' programmes. The result of this study is in line with the finding of Todd (2000) in India. This study strengthens the argument of Todd (2000) who notes that increment in productive asset is the reason behind the positive performance of MFIs' clients.

Similar to the findings in Asia, mixed results are also found in Africa. Positive insight to the microfinance services is found by Nelly and Lippold (1998) in Mali, Barnes (2001) in Zimbabwe, as well as Athmer and Vletter (2006) in Mozambique. Support for the positive view on microfinance impact is also given by Copestake et al. (2001) in Zambia. Unfortunately, they found the MFIs in this country are not directed to the poorest of the poor.

The positive trend of the impact is found in the rest of the world. The study conducted by Tsilikounas (2000) for example, found positive influence of microfinance services on the improvement of household well-being and clients' business in Bosnia. A similar result is also found by Woller and Parsons (2002) in Ecuador. However, there is always mixed results found in impact assessment study. Aroca (2005) discovers microfinance services provided by Brazilian banks register significant positive impact on the average income of their clients. Unfortunately, the NGO-based Chilean microfinance programmes registered negative result based on the similar indicators. Nevertheless, Chilean banks microfinance programme had positive impact on clients' income although the impact was weaker than their Brazilian counterpart's.

## 2.2. *Spirituality and Religiosity*

Spirituality has become an important issue in business and management studies. A lot of articles and academic papers have been published in recent years highlighted the role of this variable in enhancing leadership, satisfaction, commitment as well as performance of individuals in organizational setting. Similar to spirituality, several attempts have been made to explore the relationship between religiosity and economic performance. Many of these studies proved that this variable has positive influence to economic achievement, specifically in the entrepreneurial area.

According to Cavanagh (1999), the term 'spirituality' means many things to different people. For many people, spirituality means a search for personal meaning and a relation to the Supreme Being that many of us call God (Cavanagh, 1999). Almost similar but more complex opinions related to definition of spirituality are given by other researchers. According to Delbecq (1999), spirituality can be explained as the unique and personal inner experience of and search for the fullest personal development through participation in the transcendent mystery. The experience and development always involve a sense of belonging to a greater whole, and a sense of longing for a more complete fulfilment through touching the greater mystery, which in tradition is referred to as God.

To some extent, understanding spirituality is complicated as this term is commonly used interchangeably with the term "religiosity". However, religiosity, perhaps, is easier to explain than spirituality. Parveen and Maqbool (2007) summarize three domains of religiosity; namely concrete, abstract, and metaphysical. Religiosity is concrete as it refers to practices carried out by those who profess to a faith (Doyle, 1992). Religiosity can also be defined as something that is abstract if it refers to the attitude peculiar to consciousness, which has been altered by the experience of the numinous. On the other hand, religiosity can also be something like metaphysical or concerned with the ground and purpose of the world people call as God (Rahner & Vorgrimler, 2001).

Brandt (1996) provides a distinction between spirituality and religiosity. From his perspective, religiosity typically involves discussions about belief systems and the range of personal, familial, and work-related commitments to those systems. On the other hand, spirituality is typically seen as a somewhat broader concept of developing an individual as a 'whole person'. In other words, while religiosity has an element of acting on one's belief system or religious tradition, spirituality, however, is often thought of as a personality dimension involving the beliefs and values that pervade one's perceptions of life. For many researchers, religion also has a sense of community-based activity and ritual, while spirituality represents only the individual experience (DeNoble et. al., 2007).

Nevertheless, there is a relationship between spirituality and religiosity. According to Cavanagh (1999), historically, spirituality has been rooted in religions despite the current use in business and the workplace although spirituality is most often not associated with any specific religious tradition. There are several reasons for this separation. Firstly, most Western societies are pluralistic. Thus, there is no one dominant religious tradition that can be used as a foundation. Secondly, the use of religion in the public forum can encourage distrust, dislike for outsiders and suspicion, and that, in turn, can lead to the breakdown of democracy, and sometimes even to the start of the revolutions and war. Thirdly, the Nineteenth Century European Enlightenment has made Westerners distrustful of religious values. Religion is found to be opposed to rationality and science and the source of superstition and irrationality.

The most important conclusion behind the relationship between spirituality and religiosity is that a person can be religious without being spiritual and vice-versa. This assumption has been proven by studies conducted earlier by a series of researchers (Elkins, et. al., 1998; Pargament, 1997; Roof, 1993; Zinnabeurer et. al., 1997). Nevertheless, it is difficult to develop spirituality if not with a religious background, as many positive evidences on spirituality in the business world which has received considerable attention in recent years have been severed by religious roots (Cavanagh, 1999).

Many studies on spirituality found this variable provides beneficial impact to individuals either from psychology,

health as well as business and management perspectives. In psychology for example, leaders of the American Psychologist Association believe that spirituality is an important element of human diversity (McMinn et. al., 2009; Stuckey, 2001; Pecchenino, 2009; Kiesling et. al., 2006), adult developmental changes (Cotton et. al., 2006), and health (Litwinczuk & Groh, 2007; Bekelman et. al., 2010; Schultz et. al., 2010; Leach and Lark, 2004; and Davis et. al., 2009).

As spirituality and religiosity have been used interchangeably, there are as many studies on spirituality as there are on religiosity. Interestingly, many benefits of spirituality are also found in the area of religiosity. However, studies on religiosity are more established than studies on spirituality. Various measures of religiosity and religious participation are found to be positively associated with physical health, faith in people, subjective well-being, life satisfaction, happiness, depression, and self-esteem. It also has a negative relationship with suicide and anxiety (Brega & Coleman, 1999);

In health studies, previous researches found religiosity have a positive effect on physical and mental wellbeing and a number of measures of physical health such as high blood pressure (Levin & Vanderpool, 1987), cancer (Jarvis and Northcott, 1987), and heart disease (Friedlander et. al., 1986). Religiosity is also able to reduce high-risk behaviour such as smoking and drinking (Idler, 1987) and encourage people to be involved and interact with supportive social groups (Martin, Kirkcaldy, & Siefen, 2003)

In business and management literature, one extension of spirituality namely spirituality at the workplace has emerged as an important factor in organizational development. Neck and Milliman (1994), for example, noted that spirituality may enhance organizational performance. This opinion is supported by other studies such as McCormick (1994), Brandt (1996), Leigh (1997), and Mirvis (1997) who report organizations that attempt to promote spiritual development to their members, experience increases in employees' creativity, satisfaction, team performance and organizational commitment (Konz, & Ryan, 1999).

Specific to entrepreneurship, studies conducted by Mardhatillah and Rulindo (2007 and 2008) show a relationship between level of spirituality and micro-entrepreneur's performance. In one study, Mardhatillah and Rulindo (2007) use only a simple correlation analysis to prove the relationship between the entrepreneurs' spirituality and their business performance. Meanwhile, the second study, by Mardhatillah and Rulindo (2008) add qualitative analysis by interviewing the entrepreneurs to see how the spirituality helps them in running their business. Both of the methods, however, confirm that spirituality of the micro entrepreneurs influence their business performance.

In religiosity side, religiosity is believed to have relationship with economic growth (Galbraith & Galbraith, 2007). It is hypothesized that there is a direct relationship between religious attitudes and both economic growth and entrepreneurial activity. In addition to that, religiosity is also among the factors that contribute to how people maintain their stages of career (Ismail et. al., 2004).

Religiosity, which is measured by church attendance, is also found as improving the economic performance of newly arrived Hispanic entrepreneurs to which country who are members of the church according to the findings of Galbraith et. al., (2004). Similar findings with different backgrounds are found in the study of Champion (2003) as well as Martes and Rodriguez (2004). They also note that the entrepreneurial spirit of evangelical religious sects may also contribute to economic achievement among their immigrant members.

### 3. Method

Literature review shows there are inconsistent finding in terms of impact of microfinance on their clients. In addition, and there is no impact assessment that have been undertaken to assess contribution of specific characteristic of Islamic microfinance on their clients. Based on these finding, a conclusion can be derived that there is a need to revisit impact of microfinance, especially the Islamic microfinance. As the impact seems to be limited, there is a need to explore possibilities on how to strengthen the impact, particularly by using specific characteristics of Islamic MFIs.

There are two specific characteristics of Islamic MFIs that may provide additional impact of Islamic microfinance: modes of *Shari'ah* compliant financing and spiritual and religious enhancement programmes of Islamic MFIs. Study of Widyanto and Ismail (2006) unfortunately found no impact of specific Islamic microfinancing contracts. On the other hand, lack of study assesses impact of spiritual and religious enhancement programmes on economic performance of the clients. The effectiveness of the programme, however, can be benchmarked into the influence of clients' spirituality and religiosity of selected impact indicators of this study.

As the result, modes of financing, clients' spirituality and religiosity level will be used as independent variables of this study, in addition to other variables that have been used by previous impact assessment studies such length of receiving Islamic microfinancing, gender, education, age, number of dependants, business experiences, and location of domiciles. As dependent variables, this study selects income and poverty level of the clients. These variables are selected because these two elements are benchmark of the successfulness of microfinance

programme; to help the poor to leave out of poverty. By using these variables, this study comes out with the following model:

$$Y = f (\text{LENGTH} + \text{MODE} + \text{SPIR} + \text{REL} + \text{GEN} + \text{EDU} + \text{AGE} + \text{MRTS} + \text{DEPD} + \text{BEX} + \text{TRAIN} + \text{LOC}) \dots \dots \dots (\text{Equ 1})$$

LENGTH refers to the length of having Islamic microfinancing while MODE is modes of financing. Meanwhile, SPIR is the level of clients' spirituality, REL is the level of clients' religiosity, GEND is the gender of the clients, and EDU is the educational background of the clients. AGE refers to clients' age, MRTS is clients' marital status while DEPD is clients' number of dependants. BEX is clients' business experience, TRAIN is participation in training, and LOC is clients' location of domicile. Lastly, SIZE is size of financing and COST is cost of financing.

A number of categorizations are developed to benchmark the above variables. For spirituality and religiosity, these variables are measured based on Islamic version of Spiritual Well-Being (SWB) scale, and religiosity of Islam Scale. These scales have been tested academically and the overall reliabilities of these scales are 0.85 and 0.81 respectively (Imam, 2007; Masri and Priester, 2007)

Impact on clients' income is measured based on clients' current income Previous studies such a Kondo (2007), Widyanto and Abdul Ghaffar (2006), Montgomery (2005) and Amin et. al. (2003) also used this variable as impact indicator. On the other hand, this study employs two standards in estimating clients' poverty level. The standards are subjective and objective poverty status.

For subjective poverty status, clients will be defined as poor if they consider themselves 'poor'. This status has been utilized by Chowdhury et. al. (2005). On the other hand, objective poverty standard measures the poverty status based on poverty line income. This standard is further divided into local poverty standard (Chowdhury et. al., 2005; Amin et. al., 2003) and international poverty standard (Barnes, 2001; Todd, 2000). Local poverty standard is national poverty standard issued by related government entity, while international poverty standard is having income per capita less than USD2 a day, as suggested by the World Bank. The national poverty standard, on the other hand, actually is around one third of the international poverty standard.

This study uses clients' income to measure the objective poverty status. The measurement of the status is further divided into poverty status based on business income and household income. Business income is defined as personal income generated from business revenue. Household income is defined as business income plus income from other income-earning activities, and, or income from other household members.

This study selects clients of *Baitul Maal wat Tamwil* (BMT) one type of Islamic microfinance institutions in Indonesia as object of this study. Indonesia is chosen because this country has various types of microfinance and Islamic microfinance institutions, while BMT is selected because their serve the lowest income group as compared to other Islamic microfinance provider.

This study uses cluster sampling to generate the sample. Cluster sampling has also been utilized in previous impact assessment studies such as Khandker (1998), Chowdhury et. al. (2005), Amin et. al. (2003), and Coleman (1999). This study uses three stages of sampling method in conducting the survey. Firstly, it chooses Jakarta as the location of the study because there are 165 BMTs operating in greater Jakarta (Jakarta and its suburbans) or five percent out of the population of BMTs in Indonesia. Secondly, it chooses 20 BMTs or 10 percent out of 165 BMTs as the object of this study. Of the 20 BMTs, four of them are operated in the suburbans of Jakarta. Clients from these BMTs are used as control group to compare the impact of the BMTs in Jakarta and in suburban areas. Thirdly, simple random sampling is conducted to generate respondents of the surveys from those 20 BMTs. There are eighteen clients from each of the 20 BMTs are selected as respondents while two micro entrepreneurs who have similar business and in equal scale with BMT's clients are employed as member of the control group. In total, there are 400 respondents in this survey of which 360 respondents are BMTs clients whereas 40 are non-clients who are placed in the control group. This survey was undertaken at the end of 2008. The data from the survey will be tested by using OLS and Logistic Regressions techniques.

#### 4. Results and Discussion

The results of this study to some extent support the positive impact of microfinance found by previous studies. This study found clients having longer duration of Islamic microfinancing have greater possibility of having better business and having higher income as well as live in better economic condition.

As shown in Table 1, the result of OLS Regression shows length of having Islamic microfinancing provides significant contribution to the improvement of clients' income. Old clients, who receive Islamic microfinance for more than 2 years but less than 6 years generally have an income that is Rp.158,200 (\$14) higher than non-clients if the clients have been receiving a financing of Rp.1,000,000 (\$90). Better operational outcomes are experienced by oldest client; those who receive Islamic microfinancing for more than 6 years. These clients relatively have incomes higher than non-clients by about Rp.253,900 (\$23) when they received Rp.1,000,000 (\$90) in the form of financing from BMTs.

Regardless these positive results, this study found clients of BMTs have to wait up to two years to experience the positive impact of having Islamic microfinance. This is because the Multiple Regression fails to prove that clients who receive financing for less than 2 years also experience higher income in comparison to the non-clients.

The evidence generated from OLS Regressions is supported by the findings of Logistic Regressions. As shown in Table 2, the old and oldest clients have greater possibility to live out of poverty compared to non-clients. This judgment is made whether the poverty status of the clients is measured based on subjective and objective poverty standards. Similar to the result of OLS regression, the Logistic Regressions also fail to prove that new clients have better economic conditions compared to non-clients. Therefore, it can be inferred that BMTs have successfully achieved their objective to assist the clients out of poverty although the impact delivered by their services is not an immediate impact.

The findings initially provide a new insight to microfinance's impact assessment. This study confirms that like conventional micro-financing, Islamic micro-financing is able to provide positive impact on their clients. Like the studies of Mustafa et al. (1995), Montgomery et. al (1996), and Copestake et. al. (2001), the findings of this study suggest that the longer the length of having access to Islamic micro-financing, the better the positive impact on clients' income and poverty status.

Another contribution of this study is that it rejects the assumption that impact of microfinancing appears to decline over time (Chowdury et. al., 2005). This study found clients who have been receiving Islamic microfinancing for more than six years still have bigger probability to live over the poverty line compared to non-clients. This is evidently shown in Table 2 whenever the oldest clients have greater chance to live out of poverty compared to non-clients whether the poverty is measured by either subjective poverty or objective poverty standards. Moreover, when business income is used to measure the poverty status, based on national and regional poverty standards, these clients have the opportunity to live over the poverty line by 3.45 and 2.29 times than the non-clients respectively. This opportunity is even higher than the chance owned by old clients to live over the poverty line compared to the non-clients.

Similar to the result of OLS Regression, the Logistic Regressions show the Islamic MFIs' clients need to wait until two years to enjoy the significant impact. In addition to that, the impact tends to be more significant if the poverty level is measured by objective poverty status by using national poverty standard rather than the international one, which is much more higher than the this local poverty standard. This finding, again, show there is a limitation in the impact of Islamic microfinance.

In addition to these limitations, this study also fail to prove receiving Islamic microfinancing based on *Mudharabah* and *Musharakah* contracts provide better income and poverty status as compared to those receiving Islamic microfinancing based on *Murabahah* contracts. It is only those who receive other modes of financing, whom mostly receive *Qardhul Hassan* financing, the social-based financing that been proven as having lesser impact as compared to the impact received by those who receive *Murabahah* financing. In fact, many Islamic economists believe that *Mudharabah* and *Musharakah* financing modes are better than other Islamic modes of financing.

Initially, as shown in Table 2, those who receive *Mudharabah* and *Musharakah* financing have greater possibility to live over poverty line. However, this finding is only significant if household income is used to calculate poverty status of each microentrepreneur. This finding means, those who receive *Mudharabah* and *Musharakah* financing have better live not because of these kinds of financing only, but due to having other sources of income, in addition to income that they receive from business funded by Islamic microfinance.

Various findings are found for other variables such as gender, age, marital status, etc as shown in Table 1 and 2. Some attributes have minimum and even no significant impact, while others have significant impact. Nevertheless, focus on two specific variables of Islamic microfinancing; length of having Islamic microfinancing and modes of financing, the Table 2 shown that both variables have significant influence on clients' subjective poverty status. According to the Table of the Table, the old and oldest clients have possibility to be satisfied with their economic condition and think that they are not poor are 3.8 and 3.7 times than non-clients, respectively. Moreover, those who receive *Mudharabah* and *Musharakah* financing have possibility to think that are not poor by 2.4 percent than those who received *Murabahah* financing.

These finding urges that regardless their economic situation, even though those people are considered poor particularly according to international poverty standard, these people feel that they are not poor subjectively. There are some plausible explanations for this, including they have relatively higher spirituality and religiosity level. This assumption is strengthened by demographic analysis that those who with longer duration of receiving Islamic microfinancing, and those who receive *Mudharabah* and *Musharakah* financing relatively basically have better spiritual and religious condition.

With such spiritual and religious situation, theoretically, these clients will do not consider themselves as poor as they have faith in their God; they believe what Allah (SWT) does, does for the best. Thus, these people have

more faith in destiny as determined by Allah (SWT). Therefore, they will not consider themselves as poor when someone asks their opinion on their economic condition. According to Islam, people should be thankful to Allah (SWT) for whatever that they get. As such, if they are grateful, Allah (SWT) will increase His bounties, but if they are ungrateful, Allah (SWT) will decrease it.

The above assumption is proven by Logistic regression, as shown in Table 2, those who have higher spirituality and religiosity level have bigger possibility to have better subjective poverty status by 1.05 and 1.11 respectively. Not only limited to subjective poverty status, as shown in Table 1, when clients having higher and lower religiosity level received Rp. 1,000,000 (\$90) financing from the BMTs, the clients with higher religiosity level will received higher income approximately Rp. 90,800 (\$8.25). In term of poverty level, clients who have higher religiosity level have possibility of living over poverty line by 0.5 times as compared to those who have lower religiosity level.

The results above provide new insights into the role of religiosity in economic performance in addition to the studies did by Noland (2005) and Galbraith and Galbraith (2007). It is confirmed that religiosity is able to provide enhancement to other socio-economic measures such as education, self-esteem, family unity, and life-expectancy which in the end that may also contribute to economic growth (McCleary and Barro; 2006). From the Islamic perspectives, we may argued that the values given by Islamic teachings such as discipline, honesty, sincerity, and hard work that result from doing worships such as *shalat*, fasting, and paying *zakah* as likely reasons why respondents with higher religiosity level have better income and poverty status.

Interesting finding is found for spirituality. Although there is no significant association between levels of spirituality to income of microentrepreneurs, those who have higher spirituality level are wealthier as they have greater possibilities to live over the poverty line according to objective poverty status, especially when the status is measured by household income as benchmark of poverty line income. Although the finding on spirituality is not meets the expectation, the findings however are quite powerful as compared to previous studies. As stated above, Kauanui et. al., (2007) were not able to find the difference between micro entrepreneurs' types of spirituality with their age, gender, year in business, industry and even their business income.

In addition, although studies conducted by Mardhatillah and Rulindo (2007) and Mardhatillah and Rulindo (2008) show relationship between level of spirituality and micro entrepreneurs' performance, these studies only use simple correlation analysis and qualitative analysis to prove the association. Although, it seems that the impact of spirituality to the clients' poverty status is not directly intervened by their business income, the findings of this study at least acknowledge that these respondents are generally wealthier than their counterparts. It thus supports the common assumption that having high spirituality level is beneficial for human beings.

## 5. Conclusion and Recommendations.

The findings of this study prove that Islamic microfinance able to provide significant impact on improvement of clients' income and poverty status. However, the impact is somewhat limited as it is only can be consumed after two years of receiving Islamic microfinancing. In addition, impact on poverty alleviation is less significant if benchmark for poverty is based on international poverty standards.

Based on the above findings, Islamic microfinance institutions need to find a way to enhance their impact on their clients. Among possibilities and strategies in enhancing impact of Islamic microfinance, providing capacity building in form of spiritual and religious development program need to be considered by Islamic microfinance institutions. This suggestion is supported by findings of this study because spirituality and religiosity have significant affect on economic performance of microentrepreneurs.

As these two variables have positive relationship with improvement of poverty status based on subjective poverty standard, these variables are believed can provide immediate impact on microentrepreneurs. Although economically the clients are not living over the poverty line; they have satisfied with their life. As from Islamic perspective rich people is defined as those who have such felling; not those who have certain limit of income, improving clients' spirituality and religiosity levels are the most strategic decision that need to be taken by Islamic microfinance institutions.

Providing spiritual and religious enhancement programme can strengthen specific characteristics of Islamic microfinance. It can be a crucial factor that differentiates Islamic with conventional microfinance. For this purpose, the Islamic microfinance institutions can enhance clients' knowledge on Islamic teachings particularly in terms of *aqidah*, *ibadah*, *akhlaq* and *muammalah*, and enlighten them why these matters not only important for the *akhirah* purposes, but also for the *dunya* purposes, including for the improvement of their business performance. With strong *aqidah* and proper *ibadah*, the clients will have higher spirituality level which may enhance their passion and patience. On the other hand, with proper *ibadah*, good *akhlaq* and knowledge on *muammalah*, they will have higher religiosity level which may improve good characteristics that are important for their business such as discipline, hard working and human relationship management.

Among the substance that need to be deliver in spiritual and religious capacity building is the important that the

clients realize the presence of Allah and believe Allah will give the best to His creations. However, the clients should understand that Allah only change someone live unless he himself who need to work for it. Understanding this principle, not only by knowing it but also by believing and applying it will enhance clients' spirituality. Consequently, the clients will do their best to change their life. On the other hand, he will be more patience as they knows that if Allah willing to give them, they will get what they want.

In addition to enhance clients' understanding on the above principles, the capacity building programme should also promote the clients to be more religious. Besides the fact that it is a part of *dakwah* or Islamic preaching, the implication of being religious can also provide the clients with some beneficial characteristics. For instance, the clients will be more discipline as consequence of doing *shalah*, especially if they do it in *jama'ah* or do it with others together on time. Moreover, being religious will also enhance clients' social network as implication of *silaturrahim* and paying *zakah*. By doing these, values of these practices will promote good characters of the clients which in the long run may contribute to improvement of clients' economic performance; thus enhance impact of Islamic microfinance at the same time.

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**Table 1: Results of OLS Regression**

Variables	Income		
	Coefficient	Std Error	Sig
Less than 2 years	0.0351	0.1330	-
Between 2 to 6 years	0.1582	0.0602	*
More than 6 years	0.2539	0.0830	*
<i>Mudharabah / Musharakah</i>	0.0391	0.0944	-
Others	-0.2183	0.0779	*
Higher Spirituality Level	0.0044	0.0800	-
Higher Religiosity Level	0.0908	0.0363	**
Female	-0.0699	0.0334	**
Secondary or High School	0.0623	0.0363	***
Diploma and above	0.0212	0.2067	-
Between 30 to 50 years old	0.0604	0.1140	-
More than 50 years old	0.1725	0.1462	-
Married	0.1361	0.1868	-
Divorce	0.1797	0.3856	-
More than 4 dependants	0.0215	0.0340	-
More than 3 years	0.1186	0.1041	-
Have attend training	0.1508	0.1194	-
Jakarta	0.0508	0.0974	-
Cons	6.1647	0.0988	*
No. Observation	400	-	-
Prob > F	0.0000	-	-
R-squared	0.1510	-	-
Adj R-squared	0.1108	-	-
Shapiro-Wilk Test	0.5393	-	-
White-Test	0.9502	-	-
Durbin-Watson	1.6661	-	-

Source: Field Survey (2008)

**Table 2: Results of Logistic Regressions**

Variables	Subjective Poverty Standards		Objective Poverty Standards															
			National Poverty Standard				Regional Poverty Standard				Extreme Poverty Standard				Moderate Poverty Standard			
			Household Income		Business Income		Household Income		Business Income		Household Income		Business Income		Household Income		Business Income	
			Coeff/Odd	Sig	Coeff/Odd	Sig	Coeff/Odd	Sig	Coeff/Odd	Sig	Coeff/Odd	Sig	Coeff/Odd	Sig	Coeff/Odd	Sig	Coeff/Odd	Sig
Less than 2 years	0.5067 1.6599	-	0.1270 1.1354	-	0.1256 1.1338	-	0.2630 1.3008	-	-0.2309 0.9764	-	0.4303 1.5377	-	-0.1661 0.8469	-	0.1094 1.1156	-	-	-
Between 2 to 6 years	1.5789 4.8494	*	0.7583 2.1346	-	0.8214 2.2738	**	1.0492 2.8555	**	0.7367 2.0891	-	1.0598 2.8857	**	0.2785 1.3211	-	0.9530 2.5934	**	-1.1437 0.3186	-
More than 6 years	1.5529 4.7250	**	0.2626 1.3003	-	1.4942 4.4556	**	1.0082 2.7408	***	1.1939 3.2999	**	1.0182 2.7682	***	0.5000 1.6487	-	-	-	-	-
Mudharabah / Musharakah	1.2389 3.4517	*	0.7864 2.1955	**	0.0053 1.0053	-	0.6728 1.9597	**	-0.0074 0.9926	-	0.5247 1.6900	***	0.1226 1.1304	-	0.6066 1.8341	**	0.8282 2.2892	***
Others	0.0013 0.0031	-	-0.0855 0.9181	-	-1.0765 0.3408	***	-0.1934 0.8241	-	-0.9192 0.3988	-	0.1260 1.1343	-	-1.8784 0.1528	***	-0.7481 0.4731	-	-	-
Higher Spirituality Level	0.7193 2.0531	**	0.5450 1.7247	-	-0.0930 0.9112	-	0.5601 1.7509	**	-0.955 0.9053	-	0.7827 2.1873	*	0.2527 1.2857	-	1.0070 2.7373	*	0.7982 2.2016	-
Higher Religiosity Level	0.7470 2.1106	**	0.3876 1.4375	-	0.4688 1.5981	***	0.3953 1.4849	-	0.7119 2.0378	**	0.3586 0.4314	-	0.3014 1.3518	-	0.1219 1.1297	-	0.1092 1.1154	-
Females	0.2677 1.3609	-	0.5671 1.7631	**	-0.4334 0.6483	***	0.5868 1.7982	**	-0.3263 0.7216	-	0.6413 1.8990	*	-0.4540 0.6351	-	0.5701 1.7685	**	0.1368 1.1466	-
Secondary and High Schools	0.3693 1.4467	-	1.0715 1.7631	*	0.4830 1.6209	***	0.7985 2.2223	*	0.6915 1.9966	-	0.6532 1.9216	**	0.6886 1.9910	-	0.3791 1.4609	-	-0.8272 0.4373	-

Source: Field Survey (2008) (Continued)

**Table 2: Results of Logistic Regressions (Continued)**

Variables	Subjective Poverty Standards		Objective Poverty Standards																
			National Poverty Standard				Regional Poverty Standard				Extreme Poverty Standard				Moderate Poverty Standard				
			Household Income		Business Income		Household Income		Business Income		Household Income		Business Income		Household Income		Business Income		
			Coeff/Odd	Sig	Coeff/Odd	Sig	Coeff/Odd	Sig	Coeff/Odd	Sig	Coeff/Odd	Sig	Coeff/Odd	Sig	Coeff/Odd	Sig	Coeff/Odd	Sig	
Diploma and Above	-	-	-0.8272 0.4373	-	0.1479 0.8625	-	2.4095 11.1282	**	0.9304 2.5354	-	1.8489 6.3527	**	0.7973 2.2195	-	1.2874 3.6263	-	-	3.0177 0.0489	**
30 - 50 years old	-0.1771 0.8377	-	0.5460 1.7263	-	0.8013 2.2285	-	0.4586 1.5819	-	0.3762 1.4567	-	0.3210 1.3785	-	0.8013 2.2285	-	0.4069 1.5021	-	0.0284 1.0288	-	
> 50 years old	-0.1369 0.8721	-	0.2437 1.2760	-	0.5582 1.7475	-	0.4398 1.6386	-	0.2079 1.2311	-	0.2133 1.3679	-	0.5582 1.7475	-	-0.2359 0.7899	-	0.6677 1.9498	-	
Married	0.6209 1.8696	-	-0.5028 0.6048	-	1.1352 0.3214	**	0.4379 1.5494	-	2.0868 0.1241	*	0.2663 1.3501	-	2.0596 0.1275	*	-1.6057 0.2007	**	2.7744 0.0624	*	
Divorce	1.5427 4.6771	-	-0.9897 0.3717	-	0.9663 0.3805	-	-0.3600 0.6976	-	2.2579 0.1046	**	-0.1322 0.8762	-	0.4412 0.6433	-	-2.4945 0.0825	***	0.9663 0.3805	-	
> 4 dependants	0.6460 1.9080	***	-0.9634 0.3816	*	1.4731 0.2292	*	-0.7807 0.4581	*	1.0682 0.3436	*	-1.1940 0.3030	*	1.8939 0.1505	*	-1.1149 0.3279	*	-	1.0254 0.2895	*
> 3 years	-0.1208 0.8863	-	0.0122 1.0123	-	0.6161 1.8518	**	0.0969 1.1017	-	0.2367 1.2682	-	0.0122 1.0123	-	1.2490 3.4869	-	0.0122 1.0123	-	1.2490 3.4869	-	
Participation in Training	0.9216 2.5134	-	-0.7367 0.4787	-	0.5291 0.5891	-	-0.6605 0.5166	-	0.4062 0.6662	-	-0.4138 0.6611	-	0.6384 0.5049	-	-0.5697 0.5657	-	0.0695 0.9329	-	
Suburban	0.4138 1.5126	-	0.3135 1.3682	-	0.0374 0.9663	-	-0.4035 0.6680	-	0.7448 0.4748	-	-0.3110 0.7327	-	0.5708 0.5651	-	-0.5718 0.5645	-	0.2466 1.2796	-	
Pseudo R2	0.155	-	0.1033	-	0.134	-	0.116	-	0.1382	-	0.1244	-	0.1383	-	0.1491	-	0.1911	-	
No. Observation	400		400		400		400		400		400		400		400		400		

Source: Field Survey (2008)

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