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Microfinancing, Preference and Loyalty Analysis: A Study of Islamic Microfinance Institutions in Indonesia

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Abstract

This study aims to analyse people's preferences and loyalty to using microfinance. The research utilised a descriptive qualitative method by conducting in-depth interviews with microbusinesses and stakeholders. The research population comprised microfinance users with a sample size of 186 people from various regions in Indonesia, along with 18 people from the management of Islamic microfinance institutions. The results of the research suggest that preferences and loyalty in using microfinance are mostly influenced by the speed of service, ease of procedures, and personal relationships. Apart from that, the belief that business owners are free from usury (*riba*) is also a determining factor in choosing Islamic microfinance despite the higher cost. The findings also show that micro-business owners receive social benefits in the form of mentoring to help develop their businesses. The results of this study provide a significant contribution to understanding the factors that influence people's preferences and their loyalty to using microfinance. The research results can provide a valuable basis for stakeholders to formulate financing policies that are more suitable to the needs and conditions of the community and micro businesses.

Keywords: *Microfinance, Speed of Service, Ease of Procedure, Personal Relationship*

I. Introduction

The COVID-19 pandemic has had a negative impact on micro businesses due to social restrictions, resulting in business cessation (Bartik et al., 2020; Belitski et al., 2022; Fairlie, 2020; Ozili, 2022). Another impact of the pandemic is the increase in the poverty rate, worsening the already poor condition (Handfield et al., 2020; Valensisi, 2020). This

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condition is because micro-entrepreneurs do not have enough income to cover their living needs (Fonseca et al., 2024). In the end, many of them are forced to apply for high-interest loans, which increasingly burden their economic conditions.

After the pandemic, micro-business owners desperately need capital stimulus through microfinance. Although many microfinance schemes are burdensome for small businesses (Counts, 2022; Tan & Lin, 2016) and are not suitable for their business cycle (Lwesya & Mwakalobo, 2023; Tchakoute Tchuigoua et al., 2020), microfinance is still very popular. Besides, economically, microfinance schemes have high interest rates and create increasingly complicated problems (Wondirad, 2022). However, micro-entrepreneurs generally act very pragmatically in an effort to cover their capital needs.

The choice to use microfinance from non-formal institutions, such as personal loans, is generally influenced by convenience and fast service (Huu Thu et al., 2021; Nguyen & Canh, 2021; Rogaly, 1996). Interpersonal relationships and closeness are some considerations in obtaining microfinance (Hani et al., 2021; Henegar et al., 2024; Okello Candiya Bongomin et al., 2024), overlooking the interest or cost of the loan (Tan & Lin, 2016). Moreover, social and familial factors cause debtors to be careless in calculating loan instalments, including the principal, interest, and fines (Kabange & Simatele, 2022; Yang et al., 2023).

Microfinance with various offers, such as fast service and convenience, usually has a high credit risk (Lassoued, 2022; Singh, 2023, 2024). For lenders, the risk of default is covered by setting higher interest rates (Adusei, 2021; Ahmad et al., 2020; Uddin et al., 2024; Wondirad, 2022). Therefore, from a risk management perspective, income allowance is part of a financing risk mitigation technique (Wang et al., 2020), where the cost of the loan has already taken into account the risk of loss.

According to Alam (2010), financing schemes should be able to meet the needs of micro-businesses with various business characteristics. Accordingly, micro business owners are able to choose financing schemes that are suitable for their business, such as convenience, fast service, capital turnover, and easy procedures. Complicated financing procedures with strict requirements are not suitable for micro businesses (Nguyen & Canh, 2021). The ability to adapt to micro business conditions is needed if the financial industry is to distribute credit.

Micro businesses are referred to as unbankable despite being feasible. They are considered unbankable due to their inability to fulfil banking financing procedures and administration (M. A. Khan et al., 2020). This is because the banking industry establishes complex procedures to anticipate the risk of default. Besides, most micro-business owners cannot fulfil financing collateral requirements with strict assessments (Geremewe, 2018).

Business administration problems also often become obstacles in the distribution of microfinance (Dhamija & Singh, 2018). The financing analysis conducted by banks, including Islamic banks, needs to look at business financial reports. Meanwhile, micro-business owners are not capable of carrying out complex business bookkeeping and financial records (Ali et al., 2014). It is one of the main reasons why it is difficult to analyse micro-business owners' repayment capacity. Despite having quick turnover, poor business record-keeping makes it difficult to obtain bank financing (Musara & Gwaindepi, 2014).

From an economic perspective, by looking at the business turnover, micro-entrepreneurs actually deserve to get capital financing (Nursini, 2020). However, due to the unfit scheme, most micro-entrepreneurs prefer financing from non-banking institutions, such as cooperatives or microfinance institutions (Musara & Gwaindepi, 2014). The fast service and

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good personal relationships mostly influence the decision to choose informal microfinance institutions. Microfinance with a social touch is more popular despite the expensive cost (Geleta, 2013).

This research focuses on people's preferences and loyalty in using microfinance. This is important to understand, considering that the increase in microfinance volume must align with the community's needs in addressing the challenges of meeting their financing requirements. On the other hand, limited access to bank financing will encourage people to seek alternative sources of financing. The research results can provide a valuable basis for stakeholders to formulate financing policies that are more suitable to the needs and conditions of the community and micro businesses.

Besides reaffirming the needs of micro-businesses in obtaining microfinance, such as speed of service and ease of access (Jin & Liu, 2024; Johri et al., 2024; Mengstie, 2022), an important contribution of the article lies in the importance of a non-financial approach to microfinance, namely social mentoring. High-risk financing can be controlled if MFI management is able to provide business mentoring to clients. Therefore, in contrast to previous research, this study also includes an analysis of preferences and loyalty to the use of microfinance with a business mentoring approach, especially in Sharia-based microfinance institutions.

II. Literature Review

2.1. The Impact of the Pandemic on Micro Businesses

The negative impact of the COVID-19 pandemic has greatly affected business continuity, both for large, medium, and small businesses (Handfield et al., 2020). Research conducted by Dayrit & Mendoza (2020) and Ozili (2022) shows that all economic sectors experience the impact of the pandemic. The negative effect is mostly due to the policy on indefinite business closing and social restrictions (Susilawati et al., 2020). According to Nicola et al. (2020), only certain sectors that are related to pandemic management are not affected. The health economy actually experienced an increase due to the diversion of government budgets.

Research conducted by Wójcik & Ioannou (2020) on the impact of the pandemic on the financial service sector suggests that the sector experienced a very serious impact because many customers were unable to repay their loans. Financial institutions experienced a double impact because, at the same time, a large number of customers withdrew their savings to meet their daily needs (Akhtaruzzaman et al., 2021). If not anticipated, these risk events may lead to liquidity risk.

Business risks that arise due to the pandemic are also very high (Heo et al., 2021). These risks are generally influenced by containment policies, making it impossible for many businesses to run. For financial institutions, high business risk is one of the important determinants of not disbursing financing (Ningsih & Mahfudz, 2020). Another impact is the increasingly limited capital for micro businesses.

For the post-pandemic business recovery, business owners need to obtain enough capital. Microfinance is the right choice for entrepreneurs to access capital despite its high risks (Coronel-Pangol et al., 2023). Lin (2016) shows that microfinance has a direct impact on increasing the income of micro-entrepreneurs. However, according to Rashid & Ejaz (2019), micro-business owners rely not only on capital but also on business assistance to grow their businesses.

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2.2. Microfinance

The definition of microfinance refers to Bank Indonesia Regulation Number 14/22/PBI/2012, which was revised to Bank Indonesia Regulation Number 17/12/PBI/2015. Microbusiness financing, or what is often referred to as microfinance, is credit or capital loans provided to businesses that fall into the categories of Micro Business, Small Business, or Medium Business. Micro businesses are productive businesses owned by individuals and/or individual business entities that meet the criteria of micro businesses as regulated in Law Number 20 of 2008 concerning Micro, Small, and Medium Enterprises, namely having a net worth of a maximum of Rp 50,000,000 (fifty million rupiah), excluding land and buildings for business premises; or having annual sales of a maximum of Rp 300,000,000 (three hundred million rupiah).

The social approach to microfinance places greater emphasis on respecting the interests of all parties, as stated in stakeholder theory (Bridoux & Stoelhorst, 2022; Fiordelisi & Molyneux, 2010; López-Penabad et al., 2024). The findings of the research conducted by Adegbite et al. (2012) show that the stakeholder approach is able to reduce detrimental negative actions and, in turn, can increase company productivity. A similar statement was also conveyed by (Arandia & Hepp, 2020; Rasel & Win, 2020; and Sinha & Ghosh, 2022). Taking the interests of all parties into account also encourages increased responsibility of each party (Mustakallio et al., 2002).

Another approach to analysing microfinance by using stewardship theory was taken by Usman & Tasmin (2016). The results of the research found that one of the strengths of microfinance lies in ongoing customer assistance. With assistance, micro-business owners are able to increase their business capacity as well as their personal welfare, such as paying for their children's education (Rashid & Ejaz, 2019).

Business assistance can help build mutual social relations and, in return, will increase the trust of partners (Suhendry & Maulina, 2019). Another benefit of a social or non-financial approach is its ability to suppress unhealthy financing practices, such as conflicts of interest, moral hazard, and adverse selection (Mirakhor & Zaidi, 2007). The research conducted by Saad et al. (2013) also suggests that the Islamic financing system, in the long term, is able to reduce financing risks as well as increase profitability and socio-economic development.

The microfinance model with socio-economic assistance was researched by Arsyianti & Kassim (2017), and the results show that customers urgently need financial education because it is highly correlated with financing success. See also (Dorkas Rambu Atahau et al., 2023; F. Khan et al., 2022; Lusardi & Messy, 2023). The higher the customer's financial literacy level, the greater the moral responsibility to repay the loan according to the agreement will be (Rashid & Ejaz, 2019). In fact, research by Riduwan et al. (2022) shows that Islamic banks' commitment to serving customers during the Covid-19 pandemic has helped increase their customers' loyalty.

One of the theories relevant to the microfinance approach model is marketing theory. The approach in customer service has been studied by Pour et al. (2013), whose results show that the marketing mix can increase loyalty. Marketing is not a single approach. It requires multiple approaches, as the research findings of Sangeetha & Mahalingam (2011) and Abdul Rehman (2012) show that customers are satisfied if management is able to serve their needs.

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2.3. Theory of Planned Behavior

Theory of Planned Behavior (TPB) is a psychological theory of consumer behavior in owning a product measured from a social perspective (Ajzen, 1991). Three important indicators in TPB are attitude behavior, subjective norms, and control over behavior, all of which can be partially or simultaneously (Cuong, 2024). The research of Somoray et al. (2024) found that a combination of the three basic components can influence consumer behavior.

From an Islamic perspective, consumer behavior is also influenced by subjective norm factors in the form of religion. Religious beliefs are important clues that can encourage consumers to choose products such as Sharia compliance (S. S. Alam et al., 2020). Usury-free financial services are more attractive to Islamic bank customers because they are an important part of practicing religion (Rashid & Ejaz, 2019) and are stated in the holy book of the Koran (for example, in Surah Al-Baqarah verse 208).

III. Methodology

3.1. Sample and Procedure

The population of the research is microfinance recipients from Islamic Microfinance Institutions (MFIs) in Indonesia, spread across Bandung, Malang, Lampung, Pekalongan, Pasuruan, Rembang, Solo, Semarang, Bantul, Sleman, Kulonprogo and Gunungkidul. The sample was determined using purposive sampling with the criteria of having obtained a maximum financing amount of IDR 20,000,000 (twenty million rupiahs) with a daily instalment scheme, being involved in their small trading business every day, and having consented to be interviewed. The data was collected using Google Forms with structured questions and enriched through in-depth interviews. A total sample of 186 small traders, with a ratio of 76% women and 24% men, were successfully interviewed.

The researchers also conducted interviews with the managers or administrators of Islamic MFIs, including Itqan, Mentari, Bahtera, Bina Umat Sejahtera, Sidogiri, Bina Ihsanul Fikri, Dana Insani, Arofah, An Nikmah, and Arta Amanah. In-depth interviews were conducted with focus group discussions. Those Islamic MFIs were chosen because they finance micro-entrepreneurs with the predetermined criteria. There were a total of 18 Islamic MFI employees and officials involved in the research, bringing the total sample to 204 people. There is some disagreement about the appropriate sample size for qualitative research. However, considering the varying composition of the sample based on predetermined characteristics, the observed sample size, as described above, was able to provide the data needed to conduct an in-depth qualitative analysis of the research topic (Bekele & Ago, 2022).

3.2. Data Analysis

The primary data were obtained from direct interviews and questionnaires from micro-entrepreneurs and Islamic MFI employees and officials. Through group and individual interviews, preferences and loyalty to using microfinance can be identified. Interviews with the managers or administrators of Islamic MFIs were conducted to strengthen the research findings and synchronise the primary data. The secondary data was obtained through official Islamic MFI publications and annual reports from 2020 to 2023.

The data was analysed using a descriptive qualitative approach. This qualitative analysis employed techniques developed by Miles and Huberman, which have three stages: data reduction, data presentation, and conclusion drawing. Conclusions were drawn by classifying various micro-business preferences and identifying the causes of loyalty.

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IV. Results and Analysis

Unprivileged people who access financing through microfinance can come from various backgrounds, with the majority coming from the trade and small industry sectors. Table 1 shows the secondary data extracted from Islamic MFIs from 2020 to 2023 on microfinance recipients based on economic sectors.

Table 1. Financing Based on Economic Sectors

Sector	Credit Limit (in thousands of rupiahs)				Mean
	500-4,999 (%)	5,000-9,999 (%)	10,000-14,999 (%)	15,000-20,000 (%)	
Trade	61.2	64.1	67.6	59.4	63.1
Small Industry	23.4	22.3	20.9	27.6	23.6
Agriculture	7.2	6.9	4.1	7.1	6.3
Service	5.8	4.0	5.3	4.8	4.9
Others	2.4	2.7	2.1	1.1	2.1

Source: Secondary data from Islamic MFIs, processed by the author

Based on the data on financing in Table 1, we can see that microfinance is mostly carried out in the trade sector. A total of 63.1% of Islamic MFIs channel their financing to the trade sector. Based on the results of interviews with their officials, they focus their financing on the trade sector because it has a faster economic turnover compared to the other sectors. The trade sector generally opens every day. Thus, there is a daily cash flow.

Meanwhile, small industrial sectors, such as small-scale craft, household processing, and manufacturing industries, are placed second. The agricultural sector is not in great demand due to low economic turnover and slow circulation of funds. Financing for services and other services, such as procurement of consumptive goods and education, has not experienced a big increase because Islamic MFIs prioritise productive businesses as it is in line with the mission of the institutions.

Data regarding people's preferences in using microfinance can be seen in Table 2.

Table 2. Microfinance Preferences

Preference	Number of Debtor	%
Cost	21	11.3
Speed	45	24.2
Personal Relationship	39	21
Ease of Procedure	44	23.6
Islamic Approach	33	17.7
Others	4	2.2
Total	186	100

Source: Author's own work

Based on the data on debtors' preferences in using microfinance, it can be concluded that the most dominant factors influencing their preferences are the speed of service and ease of procedure, with 24.2% and 23.6%, respectively. The findings from the questionnaire were supported by direct testimonies from various microfinance users.

Mr. Ngadiran, a goat trader in Semanu Market, Gunungkidul, has used microfinance from BMT Dana Insani. He explained why he prefers to use microfinance from BMT (MFI). He said:

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"Because BMT provides fast, friendly service and the procedures are not complicated. If I need financing, I just call or chat via WA (WhatsApp), and the officer immediately comes to my house or meets me at the Semanu market".

A similar opinion was also conveyed by Mr. Suharsono, a Pecel Lele trader from Pleret, Bantul. He has been using microfinance from BMT Bina Ihsanul Fikri (BIF) for a very long time. He explained:

"I have been a member of BMT BIF for 11 years and always use financing with an amount of 10 million rupiah. BMT BIF always provides convenience in financing procedures. Usually, the officers will serve at any time, even if they used to take installments at night when I was selling."

The statement above emphasises that speed and ease of procedure are the two keywords that drive people's preference to use microfinance and be loyal to it over the years. Speed of service combined with ease of procedure is a significant factor in driving people's preference and loyalty.

The statement of loyalty was delivered by Mr. Puji Supriyanto, a wood recycling craft entrepreneur in Sleman. As a craftsman, he has the opportunity to get assistance and credit from banks, but he prefers to borrow from MFI, BMT Mitra Usaha Mulia, for many years. He explains the reasons:

"I have been a member for five years and received financing facilities. I am always facilitated when I need additional ceilings. The amount of BMT's financing is very flexible and able to meet my needs."

Besides that, the personal relationship between Islamic MFI officers and debtors also plays an important role here. The data shows that its influence in encouraging people's preference to use microfinance is not very different from the two factors mentioned above. Some respondents explained this from the interview results. Mr. Martono, owner of a food stall in Bantul (received microfinance from BMT As-Salam), explained:

"I am grateful for the ease of financing. Although my food stall is not big, thanks to the financing, my business can survive and even grow. BMT officers have a very good relationship, are flexible, and are easy to get along with members."

All of the above explanations are also justified by the administrators of Islamic microfinance institutions through their explanations. Mr. Sutardi, Manager of BMT BIF Yogyakarta, explained how BMT is able to compete with Islamic banks and other financial institutions in the midst of fierce competition:

"The competitive strategies that we develop in serving microfinance include building good relationships with members, fast and proactive customer outreach, easy access, and even providing business and marketing assistance. Indeed, our margins are still more expensive than banks, but because of the business assistance, members receive more benefits and ultimately maintain their loyalty."

From the explanation above, it can be seen that in addition to the various factors that have been explained in encouraging the preference for the use of microfinance by the community, business owners also get social benefits in the form of assistance or mentoring in developing their businesses.

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Islamic approach can also be one of the factors that encourage people's preference in choosing microfinance, especially those that are Sharia-based. The findings show that this is not the biggest factor, which could be due to the reason that most micro business owners do not understand the difference between Islamic and non-Islamic financing. Nevertheless, it remains a factor to consider. Mr. Abdul Majid Umar, Chairman of BMT UGT Sidogiri, East Java, explained:

"Although our assets are the largest for BMTs in Indonesia, they are still small when compared to Islamic banks, so our selling prices are sometimes less competitive. But we are able to compete because, from the beginning, we intend to worship and invite the community and financing members to also worship, especially in muamalah. That intention is to strengthen our relationship with members so that their loyalty remains good. Another thing in management, of course, is that we always do our best, such as providing service, technology, speed, ease of access, and others."

Microfinance has a significant influence on increasing business capacity (Awaworyi Churchill, 2020; Khursheed, 2022; Lwesya & Mwakalobo, 2023). There is a strong relationship between microfinance and increased welfare (Boussetta, 2022; di Magliano & Vaccaro, 2020). Microfinance schemes that are relevant to the characteristics of micro-businesses, such as offering fast service, can provide a greater impact. Microfinance with easy procedures and simple collateral assessment is preferred because it is suitable for micro businesses (Thai-Ha, 2021). Meanwhile, Rashid & Ejaz (2019) concluded that procedural flexibility is an important factor influencing the choice of microfinance.

The studies showed that ease of access is a dominant factor influencing decisions in using microfinance (Jin & Liu, 2024; Johri et al., 2024; Mengstie, 2022). Besides, the personal selling method carried out by financing officers makes the procedure very easy for debtors since they do not need to close their business to handle the financing procedure. The financing officers, on the other hand, can also help build better personal relationships with the debtors (Manaf, 2017). Personal interaction has a positive impact in preventing the risk of default (López-Sánchez et al., 2022).

One of the characteristics of micro businesses is fast business turnover, influencing the speed of financing services (Acha, 2012). Financing is often immediately needed to cover transaction needs. Another factor that influences financing preferences is the availability of a daily instalment scheme. Research conducted by Al-Shami et al. (2014) shows a correlation between daily sales and instalment models. Daily instalments are more popular because micro business owners also get their income daily. Moreover, payment flexibility can be a very helpful tool for microenterprises to grow, thus attracting them to use microfinance (Battaglia et al., 2024; Meki & Quinn, 2024).

Despite its small portion in influencing customers' preference compared to the service factor, financing with an Islamic contract is also in demand. It is in line with the results of research conducted by Rashid & Ejaz (2019), suggesting that the belief in usury-free (*riba-free*) financing influences the decision to use Islamic financing. A similar thing was also conveyed by (Abdullahi et al. 2021; Setiawan, 2023; Tuqan et al. 2024). Apart from having peace of mind, the Islamic model does not apply fines if there is a delay in paying, especially if a profit-sharing agreement is applied. The flexibility of the profit-sharing system influences customers' decisions in choosing Islamic financing (Ullah, 2014; Widarjono & Mardhiyah, 2022; Yaya et al., 2021) despite the high-profit margin or profit sharing in some instances. (Lawhaishy & Othman, 2023; Suzuki & Miah, 2021). These findings are in line with the findings in Mahmud (2015). Especially after the Covid-19 pandemic, profit-sharing financing can be an alternative (AbdulGaniyy et al., 2021).

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In addition, Adelekan (2021) found that Islamic financing, with its various product derivatives, can increase efficiency. Besides, microbusiness financing needs to consider cultural practices because they can influence economic behavior (Ali et al., 2014). Even profit sharing is actually a cultural product because it has existed since before the prophethood of Muhammad SAW (Aziz et al., 2013). However, in the Indonesian context, where the level of financial literacy is still low, Sharia financial institutions are required to be able to improve it, as recommended by Supriadi et al. (2023). Therefore, microfinance needs to consider local cultural aspects so that the risks can be controlled.

V. Conclusion and Recommendation

5.1. Conclusion

This study provides in-depth insights into the preferences and loyalty of individuals in utilising microfinance services from Islamic microfinance institutions in Indonesia. The findings reveal that speed of service, ease of procedures, and personal relationships are the dominant factors influencing user preferences. Additionally, despite the relatively higher financing margins, the belief in being free from usury (*riba*) is a primary reason for some entrepreneurs to choose Islamic microfinance institutions. Beyond financial considerations, the research also underscores the importance of social benefits, such as business mentoring, which significantly enhances the entrepreneurial capacity of micro-entrepreneurs.

The results of this research make a meaningful contribution to understanding the factors influencing preferences and loyalty toward microfinance services. This information can serve as a crucial foundation for stakeholders to design financing policies that better align with the needs of communities and micro-entrepreneurs. Efforts to strengthen Islamic financial literacy also play a vital role in increasing the appeal of Islamic microfinance institutions in the future.

5.2. Recommendation for Future Research

Discussions on this topic have enormous potential to be developed in order to refine the findings we have presented. For future research, it is recommended that the selling price factor of financing be deepened and the types of microbusinesses compared. Price is an important factor of production, so it has a high elasticity. Microbusinesses are often unable to calculate the selling price properly, making it seem as if the financing margin is not important. Given that the micro business sector also has different characteristics, preferences can also be different.

In addition, an in-depth study on the influence of local culture and social values on user preferences and loyalty can be conducted, given the diverse cultural backgrounds in Indonesia that influence the decision to use microfinance services. It can also focus on the role of digitalisation in improving accessibility and user satisfaction with Islamic microfinance, especially in the growing fintech era. In addition, analysing user segmentation based on demographics such as age, gender, and type of business can help microfinance institutions to develop more effective strategies. A comparative approach with non-sharia financial institutions can also provide greater strategic insights into the effectiveness and attractiveness of Islamic microfinance services.

5.3. Managerial Implication

The findings of this study provide a significant contribution to understanding the factors that influence people's preferences in using microfinance. The findings also indicate what motivates them to remain loyal to using microfinance, considering that they have been using it for a certain time. Therefore, it can provide a valuable basis for stakeholders to formulate

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financing policies that are more suitable to the needs and conditions of the community and micro businesses. The findings emphasise the need for Islamic microfinance institutions to enhance their customer-centric approach by simplifying procedures and ensuring fast and flexible services. Business mentoring initiatives should also be further integrated into their operational models to foster loyalty and long-term engagement with the borrowers. In addition, considering that religious aspects have a role in the preference and loyalty of using Islamic microfinance, it is hoped that Islamic MFIs will be able to utilise this as a means of approach to attract small entrepreneurs and continue to strive to improve Islamic financial literacy in the community.

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Data Availability Statement

The data associated with the findings of this research are available from the corresponding author upon reasonable request.

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