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**THE PERFORMANCE OF ISLAMIC AND
CONVENTIONAL MICROFINANCE INSTITUTIONS IN
OIC COUNTRIES: THE EFFECT OF
MACROECONOMICS FACTORS, INSTITUTIONS,
DIGITALIZATION AND SIZE**



UNIVERSITI UTARA MALAYSIA

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DIGITALIZATION AND SIZE**



By
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UUM
Universiti Utara Malaysia

Thesis Submitted to
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Philosophy



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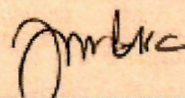
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ABSTRACT

Microfinance institutions are recognized as an important niche within the market of financial services specifically for poor people. These institutions are classified as hybrid organizations with social and financial objectives, such as striving to produce social impact by reducing poverty and at the same time remains financially sustainable. Evidence shows that some microfinance institutions achieve both social and financial objectives, some achieve one objective, while some fail to achieve any objective altogether. This study examines the impact of macroeconomic, macro-institutional factors and digitalization on the financial and social performance of Islamic microfinance institutions (Islamic-MFI) and conventional microfinance institutions (conventional-MFI) in OIC countries. It investigates Islamic-MFI and conventional-MFI using fixed effect (FE) or random effect (RE) and compares both MFIs at big and small size level using least square dummy variable (LSDV) to capture their impacts at different size level. This study uses panel data of 186 microfinance institutions which comprises of 35 Islamic microfinance and the 151 conventional institutions for the period of 2008-2019 from 34 OIC countries. From the trend analysis, conventional-MFIs appears to be a leader in all social performance measured by average gross loan size and average number of active borrowers and financial performance measured by operational self-sufficiency and loan loss rate in OIC member countries. In comparison, results indicate that most of the macroeconomic, macro institutional factors, digitalization and size factors have similar significant relationship with social and financial performance of Islamic and conventional MFIs. However, some determinants are vice versa in respect to significance level and positive or negative signs of coefficients. Therefore, the results indicate macroeconomics and macro-institutional. digitalization and size have complementary and rivalrous effects in Islamic and conventional microfinance institutions. The study gives another dimension to understanding microfinance performance in the aspects of evaluation, funding and replication of MFI in the Islamic world.

Keywords: Social performances, financial performance, Islamic and conventional microfinance institution, OIC countries

ABSTRAK

Institusi kewangan mikro diiktiraf sebagai bidang yang berkembang dan penting dalam pasaran perkhidmatan kewangan khususnya untuk golongan miskin. Institusi ini diklasifikasikan sebagai organisasi hibrid dengan objektif sosial dan kewangan dalam menghasilkan impak sosial seperti mengurangkan kemiskinan dan pada masa yang sama kekal mampan dari segi kewangan. Bukti menunjukkan bahawa beberapa institusi kewangan mikro mencapai objektif sosial dan kewangan, ada yang mencapai satu objektif, sama ada kewangan atau sosial, manakala ada yang gagal mencapai sebarang objektif sama sekali. Kajian ini menilai kesan makroekonomi, faktor makro-institusi dan pendigitalan terhadap prestasi kewangan dan sosial institusi kewangan mikro Islam dan institusi kewangan mikro konvensional di negara OIC. Ia mengkaji institusi ini menggunakan kesan tetap (FE) atau kesan rawak (RE) dan membandingkan kedua-dua institusi berdasarkan saiz menggunakan "*Least Square Dummy Variable*" untuk melihat kesannya pada tahap saiz yang berbeza. Kajian ini menggunakan data panel 186 institusi kewangan mikro yang terdiri daripada 35 kewangan mikro Islam dan 151 kewangan mikro konvensional bagi tempoh 2008-2019 dari 34 negara OIC. Daripada analisis trend, institusi kewangan mikro konvensional menjadi peneraju dalam semua prestasi sosial yang diukur dengan purata saiz pinjaman kasar dan purata bilangan peminjam aktif dan prestasi kewangan yang diukur oleh sara diri operasi dan kadar kerugian pinjaman di negara OIC. Sebagai perbandingan, keputusan menunjukkan bahawa faktor makroekonomi, institusi makro, pendigitalan dan saiz mempunyai hubungan yang signifikan dengan prestasi sosial dan kewangan bagi institusi kewangan mikro Islam dan konvensional. Walau bagaimanapun, beberapa penentu adalah sebaliknya dari segi tahap keertian dan tanda positif atau negatif pekali. Keputusan juga menunjukkan makroekonomi, makro-institusi, pendigitalan dan saiz mempunyai kesan pelengkap dan saingan dalam institusi kewangan mikro Islam dan konvensional. Kajian ini memberi dimensi berbeza berkaitan prestasi institusi kewangan mikro dalam aspek penilaian, pembiayaan dan replikasi institusi ini dalam dunia Islam.

Katakunci : Prestasi sosial, Prestasi kewangan, Institusi kewangan mikro Islam dan konvensional, Negara OIC

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LIST OF ABBREVIATION

- AGLS = Average Gross Loan Size (m-USD)
- ANAB = Average Number of Active Borrowers
- LLR (%) = Loan Loss Rate (%)
- OSS (%) = Operational Self-Sufficiency (%)
- TA = Value of Total Assets (m-USD)
- CPI = Consumer Price Index
- DCPS= Rate of Domestic Credit to Private Sectors (%)
- LFPR = Rate Labor-Force participation above 15 years of Age (%)
- GDPC= GDP/ Capita growth (%)
- GDS=Rate of Gross Domestic Savings (%)
- CoC = Control of Corruption (Index)
- GE = Government Efficiency (Index)
- PSAT = Political stability and Terrorism (Index)
- VA = Voice and Accountability (Index)
- ITU = Number of mobile users out of hundred Individual
- MFI= Microfinance institutions
- IMFIs=Islamic microfinance institutions

CHAPTER ONE

INTRODUCTION

1.1 Introduction

This section starts with the background of the study, followed by problem statement, research questions with corresponding research objectives. Subsequently, the scope and study plan will be discussed.

1.2 Background of Study

One of the key factors behind the abject poverty in underdeveloped economies, is the policy of formal banking systems of not providing financial access or credit to poor, because of their vulnerability of providing collaterals, facing difficulties in formal documentation and information asymmetries in the formal lending contracts. The repercussion of this policy excludes low-income individuals from formal banking and paves the way for informal financial system such as money lenders to offer loans at a high-interest rate, however, the vicious circle of poverty remained unrooted (Hermes & Lensink, 2007). Since then, microfinance has been recognized as an alternative tool in development process by initiating innovations in the credit contract, such as group lending, installment lending and, hence, attracted many investments as an essential element of the financial system, especially, in underdeveloped countries (Morduch & Conning, 2011).

In order to alleviate the widespread burden of poverty on a global scale, microfinance institutions (MFIs) were arisen officially on the surface in 1970 and started to offer financial services/opportunities in the form of microcredit to unbanked poor individuals,

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