



A PROPOSED INTEGRATED ISLAMIC CROWDFUNDING - MICROFINANCE (IICM) MODEL FOR POVERTY REDUCTION: A CASE STUDY OF INDONESIA

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ABSTRACT

Poverty is a complex, multi-dimensional phenomena that has captured the attention of numerous scholars and agencies globally including OIC member countries. In order to address this alarming poverty problem, some of the OIC countries have adopted the institution of microfinance as a solution, including in Indonesia. In spite of its expansion, microfinance continues to face the problem of accessing affordable financing. Hence, this paper aims to attempt to offer a viable alternative model of source of financing which is known as Integrated Islamic Crowdfunding- Microfinance (IICM) model for microfinance clients in Indonesia. In order to achieve this objective, literature on the issues of accessing to finance faced by microfinance clients and crowdfunding are reviewed critically and used in the attempt of proposing an alternative model. The proposed model will assist microfinance institutions and clients of Indonesia in identifying sustainable financing source and a viable alternative model for poverty alleviation. Through this, Indonesia will play a leading role among the Muslim countries with the noble idea of Islamic crowdfunding and microfinance in poverty alleviation agenda. It enables policy makers to plan more effective plans/strategies to enhance the potential of Islamic crowdfunding among the Muslim countries in addressing issue of poverty in general.

Keywords: Poverty; Microfinance; Integrated Islamic Crowdfunding- Microfinance (IICM) Model

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INTRODUCTION

Eradicating poverty was become one of the most important goals of sustainable development goals (SDGs) and it remains unresolved problem for most of the countries including in OIC member countries. It is estimated that 1.37 billion of the world total population of 7.1 billion live on US\$1 per day. In the 57 OIC member countries, which constitute around 1.86 billion people, 35% of the total population lives below the poverty line (Haneef et al., 2015). This is further supported by the report of COMCEC Poverty Outlook (2019) and SESRIC (2019) where the number of people who live under US\$1.90 a day in the OIC Region is approximately 241 million, with the available data for the period 2007-2017. The level of poverty in Muslim countries is considered relatively very high compared to non-Muslim countries

Indeed, poverty in OIC member countries is a multi-dimensional phenomenon and a result of a complex socio-economic and political structure of a particular country. It is associated with poor economies, poor human resources, poor social services provision, and poor policies to tackle the challenges facing human and socio-economic development. Poverty in many OIC member countries has been on such a large scale that it has become a structural phenomenon of human deprivation in terms of hunger, malnutrition, diseases, illiteracy, and low level and quality of consumption of hundreds of millions of people (SESRIC, 2019; Haneef et al., 2015; Haughton and Khandker, 2009)

Over the past two decades, policy makers, international development agencies and non-governmental organizations (NGO) of OIC countries have taken up various efforts aimed at reducing poverty in developing countries including in Indonesia. Indonesia is the fourth largest country in the world in terms of population with 237.5 million people and consist of largest Muslim population. Most of the Indonesian are involving with micro-based businesses (Capri, 2019). Micro-based businesses dominate 98.85% of total business with absorb 90.98% of the total labor force and contribute more than 50% to GDP (Maksum et al., 2020). Indeed, micro-based businesses in Indonesia have a greater accessibility to both conventional and Islamic microfinance institutions (Masyita, 2017).

According to Weiss et al. (2003) and Lensink et al., (2018), microfinance institutions are generally considered as being able to help both the chronic poor and the transitory poor to come out of poverty in various ways. For instance, for the chronic poor, microfinance institutions assist them through improving access to credit so they can finance productive activities that will allow for income growth. For the transitory poor who are vulnerable to fluctuations in income that can bring them closer to or below the poverty line, microfinance institutions provide the possibility of credit at times of need and opportunity to have regular savings. By increasing income of the poor, microfinance institutions contribute to improving the poor's basic capabilities such as good health, education, social networks and command over economic resources (Kholis, 2009; Lensink et al., 2018).

PROBLEMS AND CHALLENGES FACED BY MFIS

In spite of its potential and expansion, many previous studies highlighted the major challenges facing the microfinance industry particularly related to financing. These problems encompass high and exploitative interest rate leading to over indebtedness, limited products, lack of Shariah compliance and cultural milieus, outreach, and scaling up (Haneef et al., 2015)

Charging a very high interest rate under the microfinance institutions is a major concern that has led critics to accuse microfinance institutions of exploiting their clients. In many cases, the interest charged by MFIs ranged from 10% to 50% of the amount borrowed. This exorbitantly high rate has serious implications for the income and welfare of the poor borrowers





who must repay the principal plus these excessive costs regardless of the outcome of their businesses. High administrative, including supervisory costs of issuing small loan are commonly cited as the main reason for the high rates charged (Haneef et al., 2015; Iqbal et al., 2020)

Despite the popularity of microfinance, the available products for the clients of microfinance institutions are too limited. Initially, the existing microfinance institutions focus on credit only, neglecting other financial needs of the poor borrowers. Although microfinance industry is growing fast, the borrowers have limited sovereignty on the type of products being offered. Hence, there is a mismatch between the demand for and supply of financial services in microfinance industry. (Haneef et al., 2015; Akanga et al., 2020). In addition, Staschen and Nelson (2013) highlighted that there were three primary challenges that affect the financial inclusion which include supply and demand sides, and regulatory. Supply side challenges include high transaction cost, difficulty in accessing the clients' financial record and lack of capability in providing services to poor customers. Meanwhile, demand side challenges cover the issues of lack of capability to access to financial services due to socioeconomic and cultural issues, lack of formal identification and low level of financial literacy. Furthermore, an absence of inadequate regulatory framework particularly in protecting customers is also become a factor that affect the financial inclusion.

The problems related to cultural diversity receive less attention from researchers, policy makers and other stakeholders in microfinance institutions. According to Saefullah (2010), he argues that the stagnancy in Islamic microfinance development in Indonesia is due to the lack of attention to the cultural differences and its impact on the development of microfinance institutions. Obaidullah (2008) also asserts that the religion and cultural sensitivities of Muslim world deserve a greater attention in order to ensure the sensitivities of the Muslim borrowers in the global financial system. Karim et al. (2008) stated that innovative designs of a range of Shariah-compliant products and services would increase financial coverage to a broader segment of the Muslim clients. At the end, culture is predicated to affect the success or failure of microfinance (Saefullah, 2010). Ignoring these cultural diversities is likely to inhibit microfinance penetration and its overall performance in the society. In fact, majority of the committed Muslims confronted with the problems of poverty can be provided with Islamic microfinance services as they reject the interest-based loans by commercial banks in those countries (Haneef et al., 2015; Azmi and Thaker, 2020).

Nugroho (2015) highlighted that many commercial MFIs remain dependence on subsidy and fail to achieve a greater outreach. Many MFIs still tend to use subsidies from many sources including government, donor funds, and charities (Armendariz and Morduch, 2010). However, dependence on subsidies is not sustainable in the long term as highlighted by Zeller and Meyer (2002). Zeller and Meyer pointed out the triangle of components that are essential for successful micro financing: outreach, impact and financial sustainability. Those three interrelated components are essential for supporting and ensuring the survival of an MFIs. Hence, this approach highly undermines the social mission of microfinance to reach the poorest of the poor.

Another problem in microfinance is the asymmetric information (Ahmed 2012). There is a lack of comprehensive and reliable financial information provided by the clients. As a result, the credit risks might occur when money is transferred, which might increase the possibility of it being utilised for other purposes, thus possibly leading to non-repayment.





PROBLEMS AND CHALLENGES FACED BY ISLAMIC MFIS

According to SESRIC (2008), in most cases, Islamic MFIs face the challenges of limited funding, particularly at start up stage, scaling up stage as well as sustainable stage. It is important to have subsidized funding in order to enhance the initial operations of MFIs. Even in the case of achieving better outreach and scale-up, MFIs are likely to face huge difficulties in receiving fund either from donors or from other commercial sources (SESRIC, 2008). Thus, it is suggested that MFIs can get funding from donors and receive various grants. (Haneef et al., 2015)

Baitul Maal Wat Tamwil (BMT) in Indonesia which is considered as non-government organizations are providing Islamic microfinance services. BMT has been well developed by the establishment of the two pioneers, namely, BMT Salman in the 1980s and BMT Ridho Gusti, in Bandung, West Java, in the 1990. The rapid growth of BMT started in 1995 with large jumps in numbers during the Asian financial crisis of 1997 and 1998. According to the database of the Center for Incubating Small Business [PINBUK], currently, there are already 3,874 BMTs in the country (Yusri, 2011). BMT as a variant of the Islamic MFI and has been defined as a community-based MFI that operates under the cooperative system and non-governmental organisation domain. BMT offers some products which are quite similar with Islamic banks such as profit-loss sharing (Mudharabah and Musharakah), Murabahah, Bai' Bithamanil Ajil and Qard Hasan. Various empirical studies have concluded that BMT is effective in reducing poverty (Adnan & Ajija, 2015; Rahayu, 2020).

However, the study by Wulandari and Kassim (2016) found that the BMTs face issues in managing resources due to management weakness and tendency to serve many micro-enterprises which resulting in increased operating costs. It is further supported by previous study by [Alaeddin and Anwar \(2012\)](#), who found that BMT faced a bad debt problem because of inadequate screening process and does not have any source of alternative subsidy. Another research attempts to provide solution on how to improve the effectiveness and efficiency of BMT. The implementation of Islamic MFI preceded by selection process of micro-enterprises with additional business control, create a good relationship and incentive system is effective in micro-enterprises development and also improve household income. Thus, the study concludes that designing integrated program to improve BMT effectiveness is highly important to ensure sustainability of the BMT (Bin Mislan Cokro Hadisumarto & Ghafar, 2010; Rahayu, 2020; Wulandari and Pramesti, 2021).

[Dariah \(2012\)](#) found that many financial subsidies from external to microfinance are unstable because it usually depends on the performance. Furthermore, unstable subsidy will cause a problem to sustainability. Subsidy from external bodies is important for BMT sustainability. Maintaining BMT performance by maintain subsidy stability is a challenge for BMT sustainability (Wulandari and Kassim, 2015)

There is therefore an urgent need for an alternative model that could improve and restore the financial accessibility of client of microfinance institutions in Malaysia and Indonesia. This paper proposes an Integrated Islamic Crowdfunding Microfinance (IICM) model as a viable solution to the problem that the client of microfinance institutions in Indonesia continue to face. The proposal could help to improve the situation that is deteriorating almost all the time. The scope of Islamic crowdfunding in the microfinance institutions has not been thoroughly researched, as the phenomenon is new in Indonesia. The study highlights how the use of Islamic crowdfunding by microfinance clients via microfinance institutions has the potential to boost business activities to further increase their income and out of poverty trap.





RESEARCH METHOD

This is a conceptual paper for the development of the Integrated Islamic Crowdfunding Microfinance (IICM) Model. It is purely qualitative in nature, using content analysis. It comprehensively reviews the literature related to microfinance and Islamic microfinance issues, and existing studies related to crowdfunding to construct the IICM model.

CROWDFUNDING

Crowdfunding is known as a process of collection of funds (in small amount) from many donors or investors by using a web-based platform for a specified project, business venture or for the social cause (The World Bank, 2013). Crowdfunding can be divided into four types namely donation crowdfunding, reward crowdfunding, lending crowdfunding, and equity crowdfunding (Massolution, 2015).

Donation crowdfunding is where the collection of funds takes place for the purpose such as social, artistic, philanthropic and others. Basically, this type of crowdfunding is not based on any exchangeable of tangible value (Massolution, 2015). Reward crowdfunding is the collection of funds, where the investors or donors receive some tangible reward (such as membership rewards scheme) as a token of appreciation (Massolution, 2015). Lending crowdfunding is a platform that matches lenders or investors with borrowers or issuers to provide loans with lower interest rate, which is set by the platform (Massolution, 2015). There are some platforms arrange loans between individuals, while other platforms collect funds and then lent to small and medium enterprises. Equity based crowdfunding refers to the fund raised through online by a business, particularly early-stage funding, by offering equity interests in the business to investors (Massolution, 2015). Businesses that are looking to raise capital through this mode typically advertise online through a crowdfunding platform website, which serves as an intermediary between investors and the start-up companies.

THE DEVELOPMENT OF CROWDFUNDING PLATFORM

Over the last five years, it seems that crowdfunding platform (CFP) has achieved tremendous growth (Massolution, 2015). In terms of geographical distribution of CFP, it shows that the largest number of CFPs existed in the U.S followed in European countries. In 2014, around 60% of CFPs are existed in Europe, while around 20 % of all CFPs are based in North America. In European continents, United Kingdom is leading with more than 70 CFPs in 2014, followed by France with 70 CFPs, and Germany with around 50 CFPs (Massolution, 2015).

In terms of popularity of types of crowdfunding, reward-based and donation-based CFPs are considered to be prominent, and each type attracts substantial funds. As of 2014, the share of newly created platforms that are reward-based is 40 %, followed by donation-based platforms and lending-based platforms (each around 20 % in 2014). Meanwhile, in terms of funding volumes of different types of CFPs, it shows that based on data from 2010 to 2012, the most important types of CFP are lending-and donation-based CFPs with funding volumes of USD\$1169.7 million and USD\$979.3 million, respectively (Iizuka, 2014).

Meanwhile, in the context of successful campaign in CFPs as provided by (Massolution, 2015), majority of campaigns (62 %) are donation based. Only 15 % are reward-based or a mix of donation-based and reward-based, while 22 % are lending-based (i.e., fundraisers incur a debt). Other investment-based campaigns (equity-based) contribute with less than 1 % to the total.





CROWDFUNDING DEVELOPMENT IN INDONESIA

Kesetkibee program is one of the successful entrepreneurship programs that employing crowdfunding to raise the fund. Kesetkibee is a program that involves only women who are members of the Cooperative Women Unggaran Melati in Central Java. Under this program, the waste material from cloth garment factory is converted into a material with a certain economic value, such as a doormat. Kesetkibee program received funding of Rp 5.02 million of the total funding needs as much as Rp 5,000,000. This fund was collected from 33 donors who donate through a crowdfunding platform namely patungan.net. Furthermore, related information of Kesetkibee programs spread via media Twitter as much as 84 times and got on social networks like Facebook as much as 89 times (Sakti et al., 2014).

Another crowdfunding program is known as Craft Programme for Change. Craft Programme for Change is a program that established creative craft center namely "Sadaya Earth" in Bandung. Basically, this creative craft center is used to provide training for marginalized women with a variety of skills enhancement for handicraft business value. Initiated by Ukke Kosasih, Handmade Corca community raised funds amounting to Rp 54.05 million of total fund targets of Rp 50,000,000. Total donors in this project consist of 18 donors and the donation was made through as wujudkan.com and patungan.net (Sakti et al., 2014).

GandengTangan is known as a crowd-lending platform. The main objective of this platform is to targets social businesses and micro businesses such as those of smallholding farmers. In this crowdfunding model, entrepreneur of a project borrows money from the crowd, but once the project is realized and runs with a profit, entrepreneur is expected to pay back the initial funds. GandenTangan takes 5 percent from successful projects (Wahjono, & Marina, 2015).

PROPOSED INTEGRATED ISLAMIC CROWDFUNDING-MICROFINANCE (IICM) MODEL

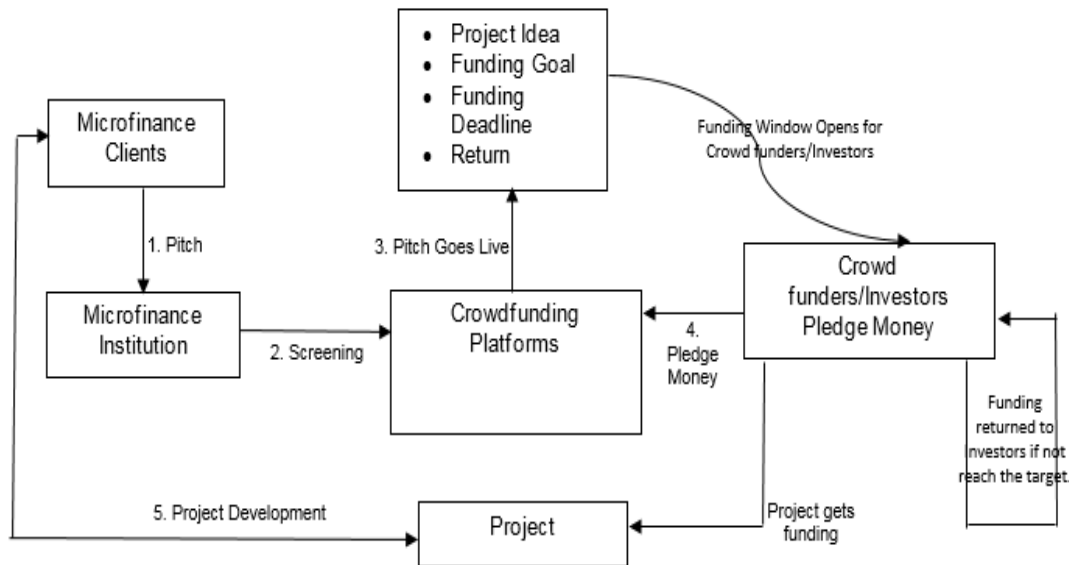
There are several alternative instruments being developed around the world to address the needs of low-income households and to give them a chance to get out of the poverty trap. These include mostly financing as well as social development mechanisms. The instruments developed to finance the needs of the poor and to give them an opportunity to sustain their livelihoods are concentrated around microfinance programs. However, households with low-income levels, particularly in Muslim communities, continue to face numerous challenges despite the alternative mechanisms being offered to them. The resources provided to them are usually not sufficient and usually do not require to have a solid project to be delivered.

Thus, given these challenges, an Integrated Islamic Crowdfunding Microfinance (IICM) model is proposed that can address the practical challenge of microfinance faced in Muslim communities, specifically in Malaysia and Indonesia. In this model, Islamic crowdfunding together with microfinance is practiced in compliance with Shariah to address the multi-dimensional aspects of poverty and empowering the poor in order to enhance the socio-economic development and hence the wellbeing of the Ummah. With this aspiration, the IICM model aims to tackle the main challenge related to scarcity of capital or financial resources in an integrated approach. The conceptual framework of the proposed IICM model is illustrated in Figure 1 below





Figure 1: Integrated Islamic Crowdfunding Microfinance (IICM) Model



Source: Authors' illustration

The following are the detailed explanation of Integrated Islamic Crowdfunding Microfinance (IICM) model:

1. Microfinance clients plan to initiate businesses. This group is less capable financially, but they have entrepreneurial skills (after undergoing training/program). They need to raise the funding from crowd funders or investors to implement the projects. They pitch their idea through microfinance institutions (arrow 1)
2. Microfinance Institutions uploads and submits the potential of particular projects' proposal to the platform which is known as Web Based Platform and Social Networks. Microfinance Institution can establish and manage its own Web Based Platform and Social Network or outsourcing from external parties. The projects have to be funded within a predefined time frame. In this model, this research proposed to use Murabahah-based crowdfunding, Sadaqah-based crowdfunding, Hibah-based crowdfunding. The platform provides an intermediate service to act as a link between an entrepreneur and potential crowd-funders (arrow 2 and 3).
3. Crowd funders or investors choose projects that they want to support and joint venture in. Crowd funders or investors browse the web to search requests and finally choose the projects they are willing to provide the fund or capital (arrow 4)
4. Crowd funders or investors transfer/send funds through payment gateways. Microfinance institution can have its own payment gateways through collaboration with existing financial institutions or crowdfunding platforms. Once the target amount of fund from crowd funders is reached, the system will update the status of projects and keep track of received fund until it is ready to be distributed. If the fund is not reached to its target, the fund will be returned to the crowd funders or investors (arrow 4)
5. If the fund is successfully raised, the system distributes the fund to microfinance institutions and notifies them to get ready managing and supervising the projects they proposed earlier (arrow 5).
6. Microfinance institutions manage and supervise their identified projects. Microfinance Institution must track the progress regularly and updates the progress into the system until the particular projects completed and started to commence by the clients. This will ensure transparency between them and the crowd funders. The system communicates





- with Microfinance institutions as for control and audit purposes through a simple communication media such as short message services (SMS) (arrow 5)
7. Later, within the specified time framework of project, microfinance clients via microfinance institutions need to provide return (for P2P-based crowdfunding) and non-monetary return (for reward-based crowdfunding) to the crowd funders or investors.

THE SIGNIFICANCE OF IICM MODEL

From the Integrated Islamic Crowdfunding Microfinance (IICM) model developed, it can be seen that the Islamic crowdfunding and microfinance can complement each other. Microfinance are means to alleviate poverty and boost the economy and Islamic crowdfunding can provide financial support for microfinance. Thus, from the broader perspective, this model could bring a significant impact to microfinance clients as well as society and economy as a whole.

IMPACT ON THE MICROFINANCE

As this model incorporates the use of Islamic crowdfunding for microfinance, it may bring benefit to microfinance. For instance, this integration of Crowdfunding with the microfinance will be useful in achieving a higher profile for the business involved and enhance the image of the microfinance. In addition, the focus of crowdfunding on business and project financing eliminates risky speculation. Furthermore, this model can increase the success of microfinance by providing assistance for their development and out of poverty trap. IICM Model can also assist in the growth of microfinance from micro to small, to medium and large scales enterprises.

IMPACT ON THE SOCIETY AND ECONOMY

The model is also anticipated to bring benefits to the society and economy. As this model emphasize on financing, it creates an environment of innovation and diversification of economic activity. It also helps to stimulate private ownership among microfinances. IICM Model enables microfinance to reach to affordable financial services. This model provides seed capital to develop microfinance sector and give them access to finance. In addition, as this model incorporates crowdfunding, it can play an intermediary role of assisting corporate sector and investors in doing their corporate social responsibility by funding microfinance clients. On the other hand, this model creates employment opportunity and helps the poor clients to generate income and thus alleviate poverty. Meanwhile, since Islamic crowdfunding could be considered as s one of the redistribution schemes, it helps to increase wealth, consumption and investment that later can boost the economy. Furthermore, as this study proposed the use of crowdfunding as the main resource, it helps to achieve efficiency of allocation of resources in the economy.

CONCLUSION

This study has shown that microfinance becomes tool for poverty alleviation in Indonesia in particular. However, microfinance is facing its own unresolved issues in terms of funding, cost of funding, accessibility, and outreach. They are considered risky segment in the market. In order to address their particular issue, the present study proposes an idea of Integrated Islamic





Crowdfunding Microfinance (IICM) model as to enhance their development and contribution to the national income.

The paper contends that IICM model can help to avoid some problems faced by microfinance institutions in Indonesia. Thus, as an alternative to mitigate the issues arising in microfinance institutions, Indonesian authority may take into the consideration to implement IICM model. The model is expected to only fighting poverty, but also generating employment, bringing about capital growth, fulfilling faith satisfaction and improving skills.

LIMITATIONS AND DIRECTION FOR FUTURE RESEARCH

This paper has at least two limitations. First, this study is only for Indonesian experience. Second, it is conceptual paper where there is no empirical analysis conducted. In order to improve this study in the future, following are some directions for further research: (i) the developed model should be validated through interview and surveys to gauge the intentions of the stakeholder in using this model. Theories such as Theory of Reasoned Action (TRA) (Fishbein & Ajzen (1975), Technology Acceptance Model (Davis, 1989) and Theory of Planned Behavior (TPB) (Ajzen, 1991) can be very useful in this regard.

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