

# Impact of Islamic Microfinance on Improving the Income and Poverty Reduction on Microenterprises in Province Aceh : Case Study in Baitul Qiradh Aceh

## Dampak Lembaga Keuangan Mikro Islam dalam Peningkatan Pendapatan dan Pengurangan Kemiskinan di Provinsi Aceh: Studi Kasus di Baitul Qiradh Aceh

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**Abstract:** Since 1995 Baitul Qiradh has been serving low-income people who mostly work as micro enterprises by providing microfinance in Province Aceh. This study was conducted to assess and analyse the impact of baitul qiradh' microfinance services to increase the income and reduce poverty among the recipients. Primary data were collected from 208 completed questionnaires distributed to the clients of 8 BQ in six district/city in Province Aceh, in order to find out their perceptions on their impacts they observed on their socio-economic lives after receiving financing from the institutions in question. The finding show that the average mean income after financing was increased significantly IDR 838.221 (42.92%) than before financing. Socio-economic factors that influence the increase customer income in this study is the level of education, amount of loan and entrepreneurial training participant. The results importantly also found that the financing has help in decrease in poverty among the clients from 39.4% before financing to 12.5% after financing. This study suggest Baitul Qiradh to improve their service not only financial side but also social services, to promote their financing products to community, to making tutorial meeting (monthly) to improve clients understanding on Islamic values in a practical way, to be more innovative in designed their financial product to fulfill the needs of their clients particular and community, and to develop link network to other financial institution (bank and non- bank), NGO dan government in implement their activity.  
**Keywords:** Islamic microfinance, BQ, Microenterprises income, and poverty reduction.

**Abstrak:** Sejak tahun 1995 Baitul Qiradh telah melayani usaha mikro berpenghasilan rendah di Provinsi Aceh. Studi ini dilakukan untuk menilai dan menganalisa dampak dari jasa keuangan mikro Baitul Qiradh untuk meningkatkan pendapatan dan mengurangi kemiskinan bagi para penerima. Data primer dikumpulkan melalui 208 kuesioner yang didistribusikan kepada pelanggan dari delapan Baitul Qiradh di enam kabupaten/kota di Provinsi Aceh; Dalam rangka mengetahui persepsi mereka tentang dampak pinjaman. Penulis juga mengamati kehidupan sosial-ekonomi mereka setelah menerima pembiayaan dari lembaga yang bersangkutan. Temuan menunjukkan bahwa pendapatan rata-rata setelah pembiayaan meningkat signifikan Rp 838,221 (42,92%) dari sebelumnya. Faktor

sosial ekonomi yang mempengaruhi peningkatan pendapatan pelanggan dalam penelitian ini adalah tingkat pendidikan, jumlah pinjaman dan peserta pelatihan kewirausahaan. Hasil penting juga menemukan bahwa pembiayaan telah membantu dalam penurunan kemiskinan di antara klien dari 39,4% sebelum pembiayaan menjadi 12,5% setelahnya. Penelitian ini menyarankan Baitul Qiradh agar meningkatkan layanan, tidak hanya sisi keuangan, tetapi juga pelayanan sosial, untuk mempromosikan produk pembiayaannya kepada masyarakat; untuk membuat pertemuan tutorial (bulanan) agar klien memahami nilai-nilai Islam dengan cara yang praktis; untuk lebih inovatif dalam merancang produk keuangan mereka untuk memenuhi kebutuhan masyarakat, serta mengembangkan jaringan ke lembaga keuangan lain (bank dan bukan bank), LSM dan pemerintah dalam melaksanakan aktivitas mereka.

**Kata-kata kunci:** keuangan mikro, Baitul Qiradh, pendapatan usaha mikro, dan pengurangan kemiskinan Islam.

### A. Introduction

Indonesia as a developing country has the world's fourth largest population with 241 million people in 2011 (ADB, 2012). The position of the large population in the absence of welfare distribution, Indonesia still dealing with a continuous socio-economic challenge as poverty and unemployment. For Indonesia, poverty problem likened to a long chronic illness, and base on data National Team to Accelerate Poverty, a number of Indonesia's poor peoples are 76.4 million and increase to 96 million peoples in 2013 (TNP2K, 2013). Poverty is caused by social issues such as lack of education, landless, no skill, not chance and given the opportunity, and belong to the group of those who are poor understanding (Mohd. Yusuf, 2004). Research Mom Njong (2010) and Owour et al. (2007) also outlines that ages and education and lack of assets (Orewa, 2008) are often attributed as a cause of poverty.

Most of Indonesia's poor work in the informal sector as microenterprises (Wielojo, 2005). Micro and small enterprise sector is an economic activity of Indonesian' people to support the people of the lower level every day (Sri Edi Swasono, 2007). This situation shows the reality of the lives of most Indonesian's people, and prove that the poor actually have the will and ability to strive. A number of micro-entrepreneurs in Indonesia reached 55,856,176 units or 98.79% than all economic actors (Ministry of Cooperatives and SMEs, 2012). And SMEs have made a strong contribution to national economic growth because it is able to absorb of labors and impact to reduced levels of unemployment and rising household incomes (Hafsah, 2004).

In Province Aceh, SMEs have a strategic position in the economy of Aceh. SMEs play a role creating jobs and economic development of the people. The number of SMEs in Aceh reached 55.783 units, which consist of micro-enterprises 39.571 units (71%), small-enterprises 13.728 units (25%), and medium-sized enterprises 2.484 units (4%) (Department of Industry, Trade and SMEs in Aceh, 2012). It is estimated that, currently SMEs Aceh has absorbed a labor about of 275 thousand people ([www.waspada.co.id](http://www.waspada.co.id) 23/01/2013). Although SMEs have big contribution to support the local economy, the reality SMEs are still apprehensive and not develop optimally. This is because SMEs especially micro-enterprises are still faced with a classic problem of limited capital.

The study of Ichsan (2012) found that some problems which are hindering Aceh' SMEs

which are related to capital. Lack of capital and low access to capital, major obstacles to the economic strengthening of the poor people (Ismawan, 2002). Limited opportunities to the poor to obtain a loan (capital) also be one of the factors they have low income (Whyley and Brooker, 2004). Lack of capital because the poor generally are assessed unbankable; they do not have collateral, low repayment ability and a low savings habits, and not able to meet the requirements set by bank. Therefore, the poor need an alternative institution, which is able to address the needs of capital they are.

Globally, an attempt to overcome the problem of capital of the poor has been made since the Microcredit Summit in 1997 and 2002, which reserves the provision of micro-loans that reach 100 million poor families until 2005. And the launching of "The International Year of Microcredit" in 2005 by The United Nations (UN) support the effort to provide opportunities for the poor to run a productive economic activity that in his time they will issue than the cycle of poverty, living normally as other communities, as well as goals to be achieved in the agenda of the Millennium Development goals (MDGs) until 2015. This program also ratified by Indonesia with the launching of the National Micro Financial Year (TKMN) on 26 February 2005. The government began to pay close attention to the Micro Financial Institutions (MFIs) its capacity as a provider of loans (credit) micro. Although in reality the majority of MFIs in Indonesia, grew by itself without any touch of the government (Seibel, 2008).

According to Sumodiningrat (2003) micro financial services through MFIs is the right approach to overcome the problem of capital among the micro-enterprises. Characteristics of MFIs to grow in the community, easily accessible, the requirements and the process for obtaining an easy, inexpensive and simple. MFIs suitable with the characteristics of micro-enterprises consisting of poor and low-income communities. Microfinance program enable micro-enterprises to expand existing economic activities and consequently boost up their income (Roslan, Fauziah, Mohd Saifoul, & Rahimah, 2007). Microfinance has a very important role to growth income and profit of micro-enterprises (Wang, 2013)

Microfinance around the world shows that a small credit to micro-enterprises may help them grow (Khandker, 2005; Woller & Parsons, 2002; Mead & Liedholm, 1998; Hossain, 1988). Hartarska & Nadolnyak (2008) indicated that the existence of Microfinance Institutions was alleviating micro-enterprises financing constraints. So, the development and sustainable microfinance is important to achieve greater financial inclusion and ensuring that all economic sectors, regions and communities have access to a full range of financial products and services (Khandker, Khalily, & Khan, 1995; Yaron, 1992). So there are four essential elements that must be owned by MFI: first, to provide various types of financial services and business development. Second, serving the poor and low-income people. Third, using the easy procedures and mechanism and fourth, the time taken to approve and disburse funds is also short.

Study Awalil Rizki (2007) on a number of BMT in Central Java, giving positive factual that existence BMT as Syariah microfinance Institution which is able to reach those who have been denied access to banking and able to meet the financial needs even in very small quantities. Similarly in Aceh, the role of Baitul Qiradh (BQ) as syariah microfinance institution

in provides financial needs of micro and small enterprises has been perceived. However, quantitative evidence of impact of micro financial is still lacking and uncertain. Reflecting on four basic principles in running the MFI as recommendation of Microcredi Summit (1997), ie, reaching the poor, reach out and empower women, build sustainability (sustainable) financial, and ensure measurable impact, this study aims to ensure the existence of a measurable impact on BQ as islamic microfinance institutions are popular among Aceh' people. And the change in income is a direct outcome of microfinance's participants perceived (World Bank, 2007). In addition, this study also aims to find potential BQ in reducing poverty among micro-enterprises.

This paper organised as follow: This section (one) present introduction, section two research questions, section three literature review, section four methodology, section five research result and discussed and final section, conclution and recommendation.

This paper aims to explore impact of islami microfinance in Provinsi Aceh, case study of Baitul Qiradh Aceh in order to improve the income and reduce poverty. Therefore, the research question of this paper are :

- i) Is the islamic microfinance can increase income of micro enterprises and what are the factors that influence increase the income among the participants?
- ii) What is the role of BQ in poverty allevation?

To fulfil the research aims and objective and to answer the research, this research adopt a deskriptive, survey and case-study-oriented research design in relation to BQ in Aceh Province, Indonesia. The method of data collection involves quantitave data collection based on purposive sampling through questionnaires distributed to microenterprise that borrow from BQ. A number of 208 respondent taken from 8 institution BQ. The purpose of questionnaires is to find how they perceive the impact of financing to their income. Therefore, the criteria of choosing the respondents were : (i) they receiving financing from BQ and using it for productive purpose , (ii) They have businees, (iii) at least 2 years as a client of BQ. Data from questionnaires are analysed with use of statistical test, including descriptive analysis, Wilcoxon Signed Rank Test and Multiple Regression.

### **B. Islamic Microfinance and Its Impact**

Contemporary Islamic financial is no longer uncertain an experience but the fact and may continue to develop rapidly. Islamic finance described as a trend revival of Islam. Islamic finance has emerged in recent decades as one of the most important trends in the world financially. The size of the Muslim population in the world is the power of the high demand among Muslims on the products and services that comply with the Shariah principles. In Indonesia, particularly in Aceh, where shariah financial has become claims should not be circumvented, let alone it is associated with the implementation of Islamic law. So that, the availability and sustainability of Islamic financial services including shariah microfinance should be a concern of Aceh government as one of the necessary institutions of society middle to lower.

Talking about islamic microfinance definition will not be separated from the general concept of microfinance understood by many people around the world, and it will allow us to understand the advantages of islamic microfinance. Microfinance is defined as “financial service for poor and low-income client’ and may include but is not limited to credit, saving, money transfers and insurance and other financial products aimed at poor and lo-income individuals (CGAP, 2010). Microfinance is formal and informal financial sector which provide financially services : microsaving, microcredit and microinsurance to the micro-economic actors (seibel, 2005), and to people who are very poor for self-employment projects to generate income in allowing them to take care of themselves and their families (Microcredit Summit, 2004; Obeidullah Muhammad 2008).

Microfinance is a development approach that provides financial as well as social intermediation. The financial intermediation includes the provision of savings, credit and insurance services, while social intermediation involves organising citizens’ groups to voice their aspirations and raise concerns for consideration by policy makers and develop their self-confidence (Robinson, 2002), promoting improvements in health, education and income, microfinance has been shown to be effective in contributing to the achievement of the first seven Millenium Development Goals (Morduch and Haley, 2002; CGAP, 2003 cited in Greeley, 2006). Microfinance has become increasingly promtent in the current literature as a key poverty alleviation tool (Navajas *et.al*,2000;Brau and Woller,2004;Chowdhury *et.al.*, 2005; Hermes and Lensink, 2007).

Therefore, islamic microfinance can be understood as financial services provided to the poor and low-income run by islamic principles. Existance of shariah financial is to meet the needs of the muslim community and remove them rather than poverty and distress (Dusuki, 2008). Akhtar and Jafri (2009) state that Islamic microfinance is an impressive tool to fight poverty. Concept of shariah microfinance based on shared values and religion make economic activities more socially embedded with the real needs of the poor in the low level (Muhammad Sila, 2009). Thus, islamic microfinance has the same function with conventional microfinance that provide financially assist to the poor and low-income and social development. But what distinguishes them is islamic microfinance provide the products financially based on the principles of shariah and implemented with values of brotherhood, mutual help and remind each other.

Financial institutions providing microloan called microfinance institution. According to Act No 1/2013 microfinance defined as financial institutions are typical founded to provide business development services and community development, which includes financing, deposit management, and the provision of consulting services for micro enterprises that are not only for profit. In this context, the MFI does not become providers of capital for community beginners or who want to open or enter to business. Various studies and literature indicate that microfinance is an effective tool for developing micro-enterprises in poverty reduction and social and economic development.

Development of Islamic microfinance predictable provide great motivation and

positive for economic development by reducing the levels of poverty and unemployment among young people through increased economic and social capital, with the spirit of entrepreneurship base on values and Islam. Many people believed that microfinance become worthy instrument in reducing poverty problem (Ahmed, 2004, 2007; Chapra 2000.2008; Kafh 1999: Masyita 2005). However, the implementation rate of success around the world have very different according to socioeconomic recipient communities. Knight and Farhad (2008) stated that microfinance directly improve the quality of life and reduce poverty. By getting loans (financing) customers can work themselves and protect themselves from external threats. The existence of the work will encourage them to get out of the poverty cycle, thus poverty will decline. Thus, Access to capital is critical and important to improve micro-enterpriseses (Leaman, Cook & Stewart, 1992).

Study of the impact of microfinance in India conducted by Panda (2009) found an increase in household income were significant (11,41%), the increase in total assets (9.75%) and deposits amounted to 42.53% among customers directly with the public instead of the customer. Panda noted an increase in the annual work with clients. Study Rahman, Rafiq, and the Moment (2009) mentions that age, education and number of workers have positive impacts that affect the increase in household income and assets. Other studies related to microfinance in Pakistan also conducted Ali & Nature (2010). They conclude that microfinance is the most important resource to provide loans and other basic financial services to improve the performance, productivity and people capacity . It will have an impact on a person's life to reduce poverty, improve living standards, such as health, education, food and other social impacts.

Microfinance has positive effect on the growth of small businesses in the city of Kumasi Ghana in improving access to credit, increase savings, business administration, and financial and managerial training to small businesses (Quaye, 2011). One study on the economic impact assessment of the micro-credit program Iktiar Amanah Malaysia (AIM) was also performed by Norma and Jarita (2011). They found that income of the customers increase rapidly before and after participate to AIM program. The study revealed a median income of RM 447 a month (before) to RM1,987 per month (after) following AIM program. The study also find that differences in educational level factor income differences among customers. Customers who have a higher education level got higher income compared with less educated customers. This study also supports previous studies conducted Kasim (2000) and Amanah Ikhtiar Malaysia (internal report AIM 2005), which presents the fact that there is a significant increase of 70% on the AIM' customer income.

Financial review on Islamic micro in 21 BMT in Java by Amalia (2009) found an increase in the average customer income before and after financing. Different test results by using the Wilcoxon t get the difference between income before and after IDR 472. 328 and it is a significant increase income. Takahashi (2010) study on microfinance in Indonesia based on a survey of 100 participant reveals that there is no immediate impact on poverty alleviation and the effect on household outcome is not significant. Beik and Purnamasari study (2011)

on Koperasi Simpan Pinjam Syariah in Central Java about the effectiveness of the procedure and its impact on the financing of micro and small enterprises in increasing the level of income. Results of the study found that the impact of the financing of the daily income after financing positive increased by 81%.

Study M. Haykal (2010) about the impact of revolving fund BRR program BRR Aceh-Nias through cooperatives and MFIs to improve the income beneficiary in Aceh province. The focus of this study, analyzing the impact revolving fund (revolving fund) BRR to improve household incomes base on educational factors, age, time of work and the amount of assistance to the improvement of people’s income. The results of research to get that educational factors, time worked and the amount of loan a significant effect to improve the income , while age has no direct effect on income.

The most recent study on the economic impact of micro financing in Thailand by Naipon (2013) suggest that Islamic microfinance has positively contributed to increase the customers’welfare. In particular to the economic impact Naipon argues that gender, age, annual household income, total land size, membership leghth and occupation contribute to impact factors. Islamic micro finance impact study was also conducted by Rijawani and Asutay (2013) on 21 BMT and BPRS in East Java with a total sample of 348 customers. This study compared the role of the two institutions in improving customer economy and its ability to eject customers from poverty. Finding from this study outlining that the average annual value of sales, net income, business spending, household spending, and the number of workers increased after using financing from both institutions. Other results indicate role of BPRS and BMT in reducing poverty. Based on the international poverty line (\$2/day=IDR 17.589/day/person=IDR 527,660/month/person), BMT’ participant successfully reduce poverty after financing only 1% and BPRS 10%. While based on the poverty line of province of East Java ( IDR 245,035/month/person) BMT’ poor pasticicipant reduce was 8% and BPRS 12,4 % reduction after financing.

**C. Result and Discussion**

**Impact on Income**

The main the goals to be achieved from the micro Financial globally is increasing its revenue. To know the exact effectiveness of micro-finance provided by BQ, wilcoxon t test was performed to compare the income of micro-entrepreneurs before and after.

Tabel 1. Descriptive analysis

| Mean income (IDR/<br>month) | Before financing | After financing | Avarage change |
|-----------------------------|------------------|-----------------|----------------|
|                             | 1 952 644        | 2 790 865       | 838 221        |

Tabel 2: Wilcoxon Signed Rank Test : Impact on Income

|                           | Income after financing – income before financing |
|---------------------------|--|
| Z                         | -11.995 <sup>a</sup>                             |
| Asymp.Sig. (p) (2-tailed) | 0.000  |

- a. Based on negative ranks
- b. Wilcoxon Signed Rank Test

The tabel 1 show comparing average income monthly before and after financing, there is a significant difference between mean income before financing and after financing IDR 838. 221 (42.92%) at significant level of  $p=0.000$  which lower than the confidence level of .05 (tabel 2). In comparison to previous findings, a research comparing the annual net income of respondents BMT and BPRS were significantly higher after financing (50%) than the annual net income berfore financing. The annual net income of BMT’s respondens were also higher after financing IDR 1.500.000 (median) than before financing IDR 1.308.333 (median). The annual net income of BPRS’ respondents were also significantly higher after financing IDR 3.000.000 (median) than before financing IDR 2.000.000 (median) (Rijawanti & Asutay, 2013). Futher, study by Beik and Purnamasari study (2011) that small enterprises’ income in Middle Java positive increased by 81% after financing, and Panda (2009) found an increase in household income were significant (11,41%) in India after financing. Thus the finding of this research is also similar to study Amalia (2009) that average monthly income’ participant Of 25 BMT/ BPRS in Java improve of IDR 472.328 (19.58%) after financing.

**Determine Factors of Increase the Income**

Performed multiple regression model to estimate the factors that affect BQ’ customer revenues in the province of Aceh. The variables used in the multiple regression analysis is the dependent variable (income after financing) and independent variables represented by variabel age, education level, amount of loan and participation in entrepreneurship training. Overall results of decision statistical analysis is satisfactory because it meets the criteria for a good decision. Value Adjusted R Square (equivalent measure is best for a budget model regression) is 0.851 that describes the model is a good equivalent. Value of regression (R) is 0.924 which explains the very strong correlation between variables independent to dependent variable. While regression equation determinant ( $R^2$ ) is 0.854 which explains the high percentage of influence given by independent variable. In other words, it expalains that 85.4% increasing in customer income is influenced by the independent variables used in this model, the remaining 14.6% influenced by other variables or factors out of this study.

Positive relationship between level education and increase the income indicate where a high level of education should ensure a high income and opportunities for access to other jobs. The results of this study is line with the findings Rahman, Rafiq, and the Moment (2009) and Haykal (2010) which states the standards of education are factors that affect income.

Education level also determines the position of someone in the work, and determine the level of income received.

Financing is a loan that is owned the people and used as capital to run the business. The acquired results reinforced Leaman, Cook & Stewart (1992) that capital is critical and important to improve micro-enterprises. Important to create opportunities for lower community get them to have a source of livelihood, one of them by providing the capital. The results of the study indicate where the amount of financing has a very strong influence in increasing income at significant value  $t = .003$  which is lower than confidence level  $\alpha = .05$ . The greater the financing provided will be greater opportunities to expand its business community and have a positive impact on the income he received.

In addition, mentoring is actually the most important in the developing micro-enterprises. Mentoring in the form of entrepreneurial training is a factor that should not be denied. Microfinance has become a mechanism for socio-economic and financially not only to reduce poverty, but also promote the development of entrepreneurial (Yunus, 2001). The result describes the entrepreneurial training has significant effect on the level of income at significant value of  $t = .000$  which is lower than confidence level  $\alpha = .05$ . Effectiveness of micro-financing depends on whether it has the flexibility to induce the participation of the poorest and whether it enables them to acquire the basic skill (Gaika, 2002). Improving skill of borrowers is needed to improve the productivity and income (Khandker, 2003). Thus, it may be concluded that training entrepreneur can improve and explore the potential of micro-enterprises which ultimately affect the income.

Age factor indicate where a person's age increasing more reduce the income. The illustrates that customers are not productive and old was not able to increase the income of economic activity compared with productive customers. However, this is not a determinant variable to increase one's income because not statistically significant at significant value of  $t = .152$  which is higher than confidence level  $\alpha = .05$ . In comparison to the previous research, this finding show similar result with finding of Haykal (2010), but contradictory with finding of Naipon (2013) which age has contribute to impact factors.

### **Poverty Reduction Impact**

Respondent income in this study may be divided to two categories, poor and non-poor based on Aceh' Poverty Line in 2013 IDR 348.172/month/person. Respondents who have incomes below poverty called poor, while the non-poor are the ones who earn the top rather than the poverty line.

Table 3 show the number of BQ' respondent who were under Indonesia (Aceh) poverty line. Analisis result obtain a reduction in the number of respondents who are poor live under poverti line before financing is 39.4 % and be 12.5% after financing. These data indicate a reduction in the percentage of poor customer is 26.9%. This positive finding provide support study on Riwijanti and Asutay (Indah 2013) that BMT and BPRS ini East Java succeeded to reduce poverty among their respondents (BMT=8% and BPRS=12.4%).

#### **D. Conclusion and Recommendation**

The main finding show that BQ in Provinsi Aceh have a positive impact in increasing income their customers. In particular, the wilcoxon signed rank test suggests positive result in which the improvement income after financing IDR 838 221 (42.92%). The factors are determine on increase the income, the result on multiple regression show that education, amount of loan and entrepreneur training participant influence increase in income, while the age not effect increase the income. Regression equation determinant ( $R^2$ ) explains that 85.4% increasing the income is influenced by the independent variables used in this model, the remaining 14.6% influenced by other variables or factors out of this study. The finding also suggest the positive role of BQ in poverti alleviation could reduce poverty the number of poor respondents who living under Aceh' poverty line at 26.9 %. Overall, it should be note that BQ has positive impact to develop micro- enterprises and has potential role on poverty reduction in Province Aceh. However, to improve their role some proposed recommendations are as follow :

- i) To improve their service not only financial side but also social services such training and mentoring will increase the develop their clients business,
- ii) To promote their financing products to community (not only the clients), because most of clients don't have good understanding relating products principle.
- iii) To making tutorial meeting (monthly) to improve clients understanding on islamic values in a practical way.
- iv) To be more innovative in desinged their financial product to fulfill the needs of their clients particular and community.
- v) To develop link network to other financial institution (bank and non- bank), NGO dan goverment in implement their activity.

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## IMPACT OF ISLAMIC MICROFINANCE ON IMPROVING THE INCOME

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