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Profitability vs Poverty alleviation: has banking logic influences Islamic microfinance institutions?

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Abstract

Purpose – The purpose of this paper is to shed some lights on the process of mission drifting or abandoning poverty objective by Islamic microfinance institutions (IMFs). The paper investigates whether the extensive use of banking logic changes IMFs, from focusing on both development and financial objectives to only considering sustainability as their primary mission.

Design/methodology/approach – This paper adopts mixed methods by analyzing 7,200 microfinance data from Microfinance Exchange Market and reviewing annual reports and websites of 25 IMFs to examine their vision and mission statements and other related information.

Findings – The finding shows Islamic microfinance has not changed, despite increasing adoption of financial or banking performance measures. However, size and age of the institutions may affect the outcome in the future. The authors find that smaller microfinance institutions maintain genuine objective to serve the poor, as the grow larger they would be more inclined toward sustainability objectives.

Research limitations/implications – The research is limited on the sample size as data on Islamic microfinance globally is limited. However, the paper looked at the global data rather than local data to compensate for this limitation. Future study would be further taking the study through qualitative methods to support the study.

Originality/value – This paper aims to shed some lights on the process of mission drifting or abandoning poverty objective by IMFIs. The paper investigates how has the extensive use of financing logic has changed IMFIs from focusing on both development and financial objectives to only considering sustainability as their primary mission. Arun and Hulme (2009) argued that the interaction of multiple logic within microfinance institutions, i.e. financial vs social, could pose some serious management dilemmas within microfinance institutions. Further, commercialization puts pressure on the field staffs to achieve financial targets and often neglect their poverty outreach mission to the poor. The well-known crisis in Andhra Pradesh, India where clients of microfinance institutions committed suicide after being shamed by field officers who tried to collect payments of loans (Mader, 2013; Taylor, 2011), provides a powerful case of the impact of financialization to microfinance clients.

Keywords Microfinance, Profitability, Sustainability, Islamic microfinance, Institutional logic, Mission drift

Paper type Research paper

1. Background

Islamic microfinance sector is an important area of research to find evidence that poverty alleviation can be effectively addressed. The failure of commercial Islamic banks to serve the poor somehow mimics the inability of conventional banks to provide necessary capital to the less fortunate segment of the society. Market failure assumption seems to hold even in the Islamic banking sector, which for many is considered as a different breed of financial institution.

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Although it is not fair to assign Islamic bank with such social objective, historical fact and strong association between the establishment of a rural bank in Egypt called Mit Ghamr and the emergence of Islamic banking in the 1970s is undeniable.

In a broader context, market failure is one of the triggers for the birth of microfinance movement (Armendariz and Morduch, 2005). They argue that market failure theory is the main driver in the development of microfinance, i.e. the failure of banks to reach out poor families or microenterprises who are in need of capital. In turn, the authors suggest that market failure is due to asymmetric information and agency problems. The success of Grameen Bank, BancoSol, Bank Rakyat Indonesia *Unit Desa*, Accion, Sewa and many other pioneers in microfinance, complemented poverty reduction programs of respective Governments in Bangladesh, Bolivia, Indonesia and India.

The conventional microfinance sector has since evolved from largely subsidized rural lending program into a sustainable microfinance industry, which attracts commercial banks and fund managers to develop customized products, either directly targeting the poor and microenterprises or indirectly through capital investments in the microfinance institutions. The focus of the microfinance institutions (MFIs) has also shifted from providing only credit to microenterprises to offering diverse financial products that serve the growing needs of the poor, such as savings and insurance. The product offering is slowly moving away from just microcredit to a range of micro-financial services, and increasingly in the recent years, to achieve a broader objective of financial inclusion (Ledgerwood *et al.*, 2012, p. 1).

There has also been an increase in academic papers discussing microfinance from different perspectives since the early 1990s. The availability and accessibility of the data has been the main reason for the increase in studies looking at microfinance sector (Brau and Woller, 2004). This is evident from publication that evaluates what have been published in microfinance field in the last three decades, for instance by Armendariz and Labie (2011), Banerjee (2013) and Cull *et al.* (2013).

Against this development, Islamic microfinance is quietly evolving from an experiment into a niche industry in some Muslim countries such as Indonesia, Bangladesh, Sudan and Pakistan. According a survey by Consultative Group to Assist the Poor (CGAP), there are at least 255 Islamic microfinance institutions (IMFs) in the Muslim world serving more than 1.28m clients (El-Zoghbi and Tarazi, 2013).

While this development is encouraging, increasing interest from large-scale institutions, rising competition and massive commercialization pose IMFs with tremendous challenges. Current market conditions require more than just a good mix of financing models, but also innovative products, sustainable funding strategy, effective use of micro-banking technology, advocating for enabling regulatory framework and above all an ability to answer the main calling for Islamic finance, which is creating an impact on the living standards of over 500m Muslims who are still in poverty and desperate for financial inclusion.

Unfortunately, as with the case of many conventional MFIs, IMFIs are facing a dilemma between pursuing sustainability of the institutions or remaining loyal to poverty alleviation mission. Morduch (2000) called this dilemma as "schism" between two primary missions of microfinance. This dilemma arises from the trade-off nature of microfinance or microcredit lending (Cull *et al.*, 2007; Mersland and Strøm, 2008; Von Pischke, 1996), where pursuing one objective, i.e. poverty alleviation through increasing outreach of loans, will cause other objective of maintaining sustainability through profit orientation to dissipate.

This paper aims to shed some lights on the process of mission drifting or abandoning poverty objective by IMFIs. The paper investigates how has the extensive use of financing logic has changed IMFIs from focusing on both development and financial objectives to only considering sustainability as their primary mission. Arun and Hulme (2009) argued that the interaction of multiple logic within microfinance institutions, i.e. financial vs social, could pose some serious management dilemmas within microfinance institutions. Further, commercialization puts pressure on the field staffs to achieve financial targets and often neglect their poverty outreach mission to the poor. The well-known crisis in Andhra Pradesh, India where clients of microfinance institutions committed suicide after being shamed by field officers who tried to collect payments of loans (Mader, 2013; Taylor, 2011), provides a powerful case of the impact of financialization to microfinance clients.

The article proceeds as follows. We begin by a discussion on the background of the paper and review the development of Islamic microfinance, followed by Section 3 on institutional logics in Islamic microfinance. Section 4 discusses hypothesis development, and Section 5 on data and methods. Section 6 presents analysis of results and visions and missions, and finally Section 7 offers some concluding remarks and recommendations for future research.

2. Development of Islamic microfinance

There are few economic models that explain the development of microfinance sector, of which is the role of enhancing the capacity of endogenous factors of production such as human capital or labour, and the other is increasing the exogenous factors such as financial capital of the poor and microenterprises. In line with this, the poverty trap argument has also been used and provides a stronger reason for improving exogenous factors or financial capacity in microfinance development. This is for instance proposed by Sachs *et al.* (2004), who argue that the lack of domestic savings and rapid population growth has intensified the poverty traps with the deterioration of capital and productivity, hence poor economic growth and advancement.

The other explanation is market failure theory, which suggests that the poor has been left out from economic growth and development due to the failure of commercial banks to provide them with capital (Armendariz and Morduch, 2005). The case of Muhammad Yunus and Grameen Bank is a leading example to this argument. So successful Grameen Bank today is almost impossible to dissociate microfinance from Grameen or Muhammad Yunus. Many subsequent efforts to establish microfinance institutions replicate the lending model introduced by Grameen Bank (Hermes and Lensink, 2007; Johnston and Morduch, 2008; Cull *et al.*, 2009).

There are however observers who retrace the history of microfinance or microcredit long before the emergence of Grameen Bank, or BancoSol of Bolivia or Bank Rakyat Indonesia for that matter, and suggest that microcredit has been there from the beginning (Attuel-Mendès, 2012). The experience of microcredit or similar movement in the nineteenth century has also been associated with the microfinance movement, among others the farmers credit union in Ireland (Hollis and Sweetman, 1998), rural credit cooperatives in Germany (Guinnane, 2011) and some similar movement in countries, such as Indonesia, Philippines and Thailand (Adams and Fitchett, 1992). In the more recent period, the experience of Indian sub-continent or Latin America also caught the attention, such as Sundaresan (2008) who attributed the development of microfinance in 1950–1980s to Accion and Sewa Bank in Latin America and India, respectively, in addition to Grameen Bank.

The basic premise of microfinance is to enable the poor emerging from poverty and at the same time deliver sustainable return for the providers of microloans and micro-financial services. This is often called double bottom line, i.e. social impact of poverty reduction and financial sustainability of the MFIs. In the process, it is hoped that this movement will enable a least developed country to develop a mature and inclusive financial system. However, the balancing act of attaining these two objectives, often conflicting by nature, is not easy. Putting more emphasis on social dimension may create adverse or unwanted consequences such as dependence on subsidy, lower outreach or lack of sustainability; likewise, an emphasis on sustainability may divert the attention on the poor to profitability of the MFIs.

The later strategy is criticized as being a mere "schism" (Morduch, 2000), where the author puts forward critical reviews on the proposition that banking approach to microfinance is said to be more efficient in poverty reduction. He alludes that the proposition (also known as win-win proposition) is neither supported by logic nor empirical evidence; in fact, it has created dichotomy or unnecessary trade-off in the microfinance movement between sustainability of the MFIs and social impact on the poor.

Today, conventional microfinance has evolved from sole offering of credit to an array of financial services, or a change from microcredit to microfinance (Matin *et al.*, 2002), and lately a shift in institutional focus from subsidy dependence to sustainable profit seeking entity (Cull *et al.*, 2009). In addition, microfinance is also being mandated to also increase the number of people that have interactions with financial institutions, i.e. to increase number of people with bank accounts. The movement of financial inclusion is among others led by the World Bank. In a new book *Banking the World* (Cull *et al.*, 2013), this narrative is highlighted and illustrated by some empirical evidence from all over the world. The main argument in this book is that microfinance would be able to increase the number of unbanked population, currently about half of the world population by at least 50 percent in the next 20 years. Clearly this is not an easy task given to microfinance, as many MFIs might resort to an arguably easier commercial objective and moving further away from meeting more difficult social objective of poverty alleviation.

2.1 Islamic microfinance as development institutions

The challenges facing IMFs are coming from various directions. They include intensifying competition from commercial Islamic banks and conventional banks or MFIs, tightening of regulatory framework governing MFIs in many jurisdictions, securing sustainable funding as many donor funds or government subsidies are evaporating, as well as balancing a prevalent trade-off between poverty outreach and financial sustainability.

Competition is the main theme for many providers of Islamic microfinance, in addition to funding sustainability and balancing between the bottom lines or choosing the right lending models that are available. The challenging situation can be best explained by the state of competition in the sector, whereby up to five key providers can control between 70 and 80 percent of the market share. In Indonesia for instance, the microfinance sector literally belongs to the big players such Bank Rakyat Indonesia, Bank Mandiri, BTPN and few other commercial banks. The same is true with the dominance of BRAC, ASA and Grameen Bank in Bangladesh; and in a larger scale, multinational groups such as BRAC, FINCA or Accion operate locally in many countries with established lending model and products, as well as access to funding from international markets.

This section will address some of these issues and followed by some suggestions on how to deal with them. But the first is internal assessment of the strengths of Islamic microfinance and its unique propositions.

2.2 The main proposition of Islamic microfinance

The main characteristic of Islamic microfinance is the absence of *riba* and the use of different financing contracts, unlike conventional system that relies heavily on credit or loan on interest. There are at least three types of contracts available is Islamic finance, namely, equity based or micro-equity, trade finance-based or microcredit and charity based. Of these modes or contractual arrangements, the partnership contract of *musharakah* is seen as the most suitable for IMFs (Smolo and Ismail, 2011). In *musharakah*, both MFI and its borrower are partners in a business venture, where sharing of equity (one can contribute goodwill, cash or other form of assets) or profit/loss is agreed upon at the beginning of the contract. However, in practice, most of the IMFs predominantly use *qardh hasan* and *murabahah* as suggested by Ahmed (2002).

This is unfortunate, as *musharakah*, and for that matter *mudharabah,* contract has so much to offer for Islamic microfinance. For instance, *musharakah* contract provides adequate commercial incentive for MFIs and banks (Akhtar, 1997), protects the borrowers from inflation pressure on their assets or investment (Abdalla, 1999) and it could also provide a basis for sustainable form of financing for the economy at large (Harper, 1994).

In recent years, there are several attempts that explore the application and applicability of these schemes to Islamic microfinance, such as housing finance using Islamic cooperative scheme targeted for the poor (Ebrahim, 2009), or an experiment on the repayment behavior of Islamic microfinance borrowers as tested by El-Komi and Croson (2013), who use experimental economics to confirm the feasibility of Islamic microfinance in the context of information asymmetry and verification.

Both studies suggest that Islamic micro-financial services are robust and in certain cases more efficient that other types of financial services targeting the poor. In the case of El-Komi and Croson (2013), the experiment results show that borrowers using *mudharabah* and *musharakah* contracts are more likely to comply with their terms of loans than those under interest based loan arrangement. It is suggested that Islamic microfinance is more efficient where information asymmetry assumption holds. Similarly, Smolo and Ismail (2011) find that Islamic microfinance would be able to resort to more sources of funding than their conventional counterparts, as well as use more variety of products to suit different type of clients. The current raising trend of Islamic social funding such as the use of Zakat, Sadaqah and Waqaf provide unique alternative as thee contracts are benevolent in nature.

2.3 The spread of Islamic microfinance

Islamic microfinance has enjoyed a relatively strong growth in the past ten years, along with the "booming" of Islamic banking and finance. Unlike Islamic finance, which is driven mainly by such financial centers as Dubai, Kuala Lumpur and London, Islamic microfinance emerged in developing countries. It flourishes in the developing economies of South Asia (Pakistan, Bangladesh), South East Asia (Indonesia, Malaysia) and Sub-Saharan Africa (Sudan). Among the front runners are Islami Bank Bangladesh, Akhuwat in Pakistan, Amanah Ikhtiar Malaysia and Agricultural Bank of Sudan.

Today, IMFs can be found in more than 15 countries across Asia (Afghanistan, Indonesia, Bangladesh, Pakistan and Malaysia), Middle East and North Africa (Bahrain, Egypt, Iraq, Jordan, Lebanon, Palestine, Sudan and Yemen), Central Asia (Kazakhstan, Kyrgyzstan) and Eastern Europe (Bosnia Herzegovina, Kosovo).

2.4 Delivery models

From a recent study by CGAP (El-Zoghbi and Tarazi, 2013), it is suggested that the majority of IMFs are operating as rural banks (up to 77 percent), followed by non-governmental organizations or NGOs (10 percent), non-bank financial institutions (5 percent), cooperatives (4 percent) and commercial banks (3 percent). While this is based on sample size of 255 Islamic MFIs, the real proportion from overall population of Islamic MFIs worldwide could be similar to this study. What the study also reveals is that commercial Islamic banks (represented by only 3 percent) seize some 60 percent of the Islamic microfinance market share, i.e. number of clients reached, much more than the NGOs and rural banks that only serve about 17 and 16 percent of the clients, respectively.

To understand the CGAP survey and institutional structure of IMFIs, the following subsections will discuss differences of each type of IMFIs based on funding, cost, clients and approach to poverty alleviation.

2.5 Sources of funding

As the sector grows and competition intensifies, securing funding for the fast growing number of clients is among the key ingredients for future success and survival of Islamic MFIs. While funding sources might not be limited, for now, selecting the one that suits internal strategy and targeted group of beneficiaries are crucial.

Savings and deposits that are designed to mobilize funding from clients or other third parties remain important instruments for many MFIs. As of 2010, Microfinance Exchange (MIX) market recorded that deposits and savings account for nearly half (47.56 percent) of the funding structure for most MFIs in the world. Debt and equity follow suit with 28.79 and 18.29 percent contribution to the total funds raised by MFIs. Another study finds that 65 percent of these MFIs are relying on deposits, borrowing from international institutions come second and accounts for 27 percent, shares or equity 20 percent and only 1.7 percent based on bonds (long-term debt). Deposits constitute 74 percent of time deposit, 26 percent savings and negligible 0.1 percent from checking account.

For Islamic microfinance, shariah compliant funding instruments are widely available and should provide alternatives for Islamic MFIs. One such example is sukuk, which in recent years has been considered as an attractive way to raise funds, but yet to be launched, to support the expansion of microfinance institutions. The main obstacle in attempting to issue sukuk is a long and demanding process and procedure, despite an obvious demand and the fact that many investors are already familiar with sukuk structure. However, in the long run, this method should be considered as a feasible and possibly the least costly mode of funding for microfinance.

3. Institutional logics in Islamic microfinance

Society is constituted through multiple institutional logics which shows that patterns of organizational behavior very institutionally (Friedland and Alford, 1991). In this study, the IMFs have their own patterns that are characterized by its economic system, which construct their identity on how they play the role in constructing logics. This paper is concerned on the competing logics within the IMFs in order to conceptualize organizational change and their practical variations. The concept of institutional logic is a way of understanding how actors' selections are conditioned by specific frames of reference that inform the sense making, the vocabulary of motivation and identities that actors bring to the situations (Ezzamel *et al.*, 2012). As this paper is concerned on macro setting of organizations, Table I describes ideal types of institutional logics in the financial reporting standardization field within the Islamic international financial architecture.

The table describes how IMFIs extend its religion and social logic that later, appeared to be very much similar to banking logic. Although the root of the logic for Islamic Microfinance is derived from the religious connotation, in ensuring IMFIs are well supported by the shareholders and funders, they have to operate commercially entrapping them to further pursue financial performance and not merely social driven. This finding is in the same vein with Battilana and Dorado (2010) who argued that commercial microfinance organizations combined development and banking logics. The sources of identity inform that visions and missions of the IMFIs are built upon the social logic however they are shifted to emerging-banking logics due to the commercial contracts. Therefore, their missions are changed from social to commercial bonding. However, this prediction is further confirmed with the data analysis below.

4. Hypothesis development

Through this paper we seek to address the issue of mission drift among IMFIs, in balancing their dual objectives of poverty alleviation and outreach *vis-à-vis* profitability objectives. The former serves the primary objective to help the poor, while the latter denotes the

Characteristics	Extant-religion logic	Emerging-social logic	Emerging-banking logic
Economic system	Religious organizations	Islamic system	Capitalism in Islamic system
Sources of identity	The organizations must be imbued with Islamic values	Vision and mission of Islamic Microfinance Institutions (IMFIs)	Commercial contracts
Sources of legitimacy	"Islamic" as title	Funding from charity and commercial organizations	Scale and scope of the organization
Sources of authority	Objectives of Shariah (*Maqāsid Shari'āh)*	Charitable organizations	Commercial organizations
Basis of mission	Islamic framework of SDGs	Eradicate poverty, empower the poor (social bonding)	Commercial bonding
Basis of strategy	Achieving SDGs for benefit of all stakeholders (whole mankind/*Rahmatan lil Ālamīn)*	Approaches to empower the poor	Growth through global partnership

Source: Mukhlisin and Fadzy (2016)

Table I.
Ideal types of institutional logics in the Islamic financial architecture

importance of profit for IMFIs in order to be sustainable. Although the ideal situation is where both objectives are met, the increasing trend is for the MFIs in general to concentrate on profitability, i.e. to achieve sustainability. The main challenge of microfinance organization is to secure stable funding for it to plan and be sustainable. Charitable contribution is a low cost of funding, however unpredictable which may result in difficulties for the MFIs to plan their operation. On the other hand, financialization of MFIs attract stable funding for commercial entities but at the cost of expected returns, which denotes charging higher rates to the borrower translated to higher returns to the funder.

4.1 Poverty outreach and mission drift

As suggested by the literature, Islamic financial institutions (IFIs) are socially and religiously driven, which means they may have strong preference toward social objectives and less inclination to commercial gain. The formation of the first Islamic bank was motivated by the lack of shariah compliant financial services accessible to devout Muslim farmers in rural Egypt, hence the establishment of Mit Ghamr Bank in 1963 (El-Komi and Croson, 2013). The same motive to improve welfare of the Muslims and serve their needs for interest-free financial services was the main driving force behind the establishment of succeeding Islamic financial services, including Tabung Haji in Malaysia, Islamic Development Bank and Dubai Islamic Bank.

This close association with the well-being of their customers has also motivated the subsequent creation of IMFIs (Elhiraika, 1996, Harper, 1994). An inclination toward social objective should drive IMFIs to concentrate on poverty alleviation and aim to serve as many poor clients as possible. This is also supported by the nature of funding sources of IMFIs. According to Ahmed (2004), large numbers of IMFIs are funded by donors, government programs, and increasingly charitable instruments such as compulsory alms giving (*zakat)*, or voluntary trust endowment funds (*waqf)*.

It is therefore appropriate to classify IMFIs into "welfarist" type of microfinance, as oppose to "institutionist." Welfarist microfinance is characterized by an overall objective to alleviate poverty and improve the well-being of the poorest segment in the community, hence propagates outreach as the primary goal of MFIs. On the other hand, institutionist microfinance emphasizes the important of sustainability and long-term operations of MFIs with the aim to serve larger number of poor people for a much longer period (Morduch, 2000; Hermes *et al.*, 2011).

The objective of many IMFIs is to serve the poorest among Muslim communities and gradually improve their sustainability (Ahmed, 2002). Hence, they are closer to the welfarist characteristic as welfare and social objectives are prominent goal for IMFIs. However, IMFIs are also committed to improve their sustainability as they progress and aim for double bottom line. Clearly, there is a growing acceptance that a compromise between profitability and poverty outreach is possible (Morduch, 2005).

IMFIs are relatively smaller in their scale of operations, having shorter history and equipped with less capital than conventional microfinance sector, hence they may not be able to reach out to a larger number of poor people, unlike conventional MFIs. This condition suggests that IMFIs may serve fewer poor people or lower outreach than conventional. However, the size would not affect overall outreach of IMFIs, as majority are located in rural areas or local communities. Hence, the proxy to outreach, i.e. changes in number of active borrowers will remain high. Therefore, the first hypothesis can be postulated as the following:

H1. IMFIs to have higher outreach than profitability i.e. Number of Active Borrowers will be higher.

4.2 Profitability and sustainability

Profitability is an important and desirable outcome for a financial institution, including IMFI. Profit is both an intermediate target to sustain the operations and as primary motive for some of the MFIs. Both Islamic and conventional MFIs have a comparable combination of the MFIs with either profit oriented or non-profit oriented. However, profit orientation does not guarantee better financial performance or higher profit, as suggested by Roberts (2013) who finds that a stronger profit motive only lead to higher interest rates. In fact, profitability of MFIs in general are influenced by both higher interest rates and manageable capital cost (Cull *et al.*, 2007).

In the case of IFIs, although profit is recognized, majority of them including IMFIs are religiously and socially driven, hence a strong preference to socio-economic objectives such as poverty alleviation or social welfare. Likewise, cost factors are particularly high and restrain financial performance of many Islamic banks and other IFIs, especially their efficiency and stability (Beck *et al.*, 2013). In addition, many IMFIs are not economically viable due to high administrative cost and shortage of funds (Ahmed, 2004).

IMFIs also engage with customers who are mostly poorer than the average customers of conventional MFIs, and often these customers live in the areas or regions that are prone to natural disasters and (not unlikely, also prolong armed) conflicts. In addition, IMFIs operating in difficult regions must employ field officers who are not only capable to mitigate hostile working environment, but also equipped with sufficient understanding of Islamic financial transactions. Unfortunately, this type of workforce is not easy, nor cheap, to find. In the end, IMFIs must operate at a much higher overall cost than their conventional counterparts or other competition:

H2. IMFIs are less profitable and less sustainable, i.e. ROA will be lower.

5. Data and methods

We use mainly quantitative data from MIX market database that is available from its website www.mixmarket.org. The database provides updated financial and social performance information for most MFIs in the world, as the data set covers more than 7,200 MFIs globally. However, IMFIs only constitute about 3 percent of the total samples, or 25 (Table AI) IMFIs in total. Despite such low coverage, MIX market is currently the most reliable and widely used database for microfinance studies. This add up to the limitation of date to the study, though still reliable as it compiles accessible IMFIs globally.

MIX database does not classify MFIs into type based on operational nature of the MFI. For this research, an additional category of Islamic and conventional type MFI is introduced to enable proper analysis. This is the main variable of the data set, as the main dependent variables will be tested against a dummy variable of IMFs.

The process of classifying MFIs into Islamic or conventional is carried out manually. We first identify regions where there has been evidence on the presence of IFIs, and remove other regions from the data set. The second step is identifying all the MFIs in these selected regions (four altogether) that are IMFIs. IMFI is defined as any entity that offer Islamic microcredit products and services, either as full-fledged shariah compliant MFIs, or partially, i.e. as a unit or windows operations of conventional MFIs. Majority of the IMFIs in the data set are full-fledged shariah compliant IMFIs, with only three of them are conventional MFIs with Islamic microfinance business branch, unit or products. Finally, once all MFIs in the database can be ascertained that they are offering Islamic microcredit products or otherwise, a new variable is introduced to the data set and the MFIs are categorically assigned their respective type. This variable, *MFIType,* is new to studies that use MIX database.

To complement this research, we also review annual reports and websites of all 25 IMFIs to examine their mission and vision statements, and other related information. We access these sources from 1 to 30 of April 2016 (data) and October 2017 (visions and missions). The list of the IMFIs selected under study is mostly from GIFR (2014) (Table II).

The paper adopts model used by Cull *et al.* (2007), Kar (2011, 2013) and Vanroose and D'espallier (2013). While these studies classify the analysis based on lending methodology of the MFIs, we classify the analysis based on the type of MFIs either conventional or Islamic. The MFI type is presented as an IMFI and MFI dummies and examined against sustainability, outreach, as well as risk indicators. For *MFItype_Islamic*, it is 1 for IMFIs and

Table II. Islamic microfinance institutions in the data set

No.	Country/IMFIs	Country	Legal status	Number of active clients
1	Islamic Investment and Finance Cooperatives	Afghanistan	Cooperative	22,711
2	Mutahid DFI	Afghanistan	NBFI	3,194
3	FINCA – Afghanistan	Afghanistan	Village bank	29,047
4	Family Bank	Bahrain	Bank	572
5	Muslim Aid	Bangladesh	NGO	39,528
6	Islami Bank Bangladesh – Rural Development Scheme	Bangladesh	Bank	569,820
7	Prva Islamska Mikrokreditna	Bosnia Herzegovina	NGO	1,321
8	MBK Ventura	Indonesia	NBFI	492,991
9	Al-Takadum	Iraq	NGO	12,023
10	Al-Thiqa	Iraq	NGO	15,572
11	FINCA - Jordan	Jordan	Village Bank	15,416
12	START Microfinance	Kosovo	NBFI	3,000
13	Al-Majmoua	Lebanon	NGO	36,726
14	Amanah Ikhtiar Malaysia	Malaysia	NGO	241,965
15	Akhuwat	Pakistan	NGO	235,517
16	Wasil	Pakistan	NGO	4,537
17	Family Bank	Sudan	Bank	58,909
18	Pased	Sudan	Bank	6,006
19	Jabal al-Hoss	Syria	NGO	1,128
20	Al Amal Microfinance Bank	Yemen	Bank	58,909

Source: Websites of each MFIs

0 otherwise; likewise, it will 1 for conventional MFIs in *MFItype_conventional* and 0 for other type of MFIs.

We use the following estimation methods for all research questions:

$$Y_{it} = \alpha + \beta_1 \mathrm{IMFI}_{it} + X_{it} + \varepsilon_{it}.$$

Y is vector of dependent variables consisting of indicators that could measure the model or estimation method, while X_{it} are group of independent variables and ε_{it} is error term.

The model estimates profitability or sustainability and outreach of IMFIs. The objective of this regression is to determine whether IMFIs are serving more poor customers, i.e. outreach or more concerned with profitability. The indicators used as dependent variables are log number of active borrowers and return on assets (ROA).

Log number of active borrowers measures breadth or scale of outreach, which examine number of the poor customers are reached and served by IMFIs, regardless of the size of loans or the gender of the borrowers. Whilst, ROA is the profitability measure that provides an indication whether the MFIs are making enough returns or not, given a certain size of total assets.

Independent variables consist of a group of sector firm level, as represented by X_{it}. The first one is real yield to loan portfolio, which is earning generated from a given portfolio and then outreach indicators, i.e. loan balance, percentage of female borrowers, to estimate the effect of outreach. In addition to cost per borrower (log_*CPB*), portfolio quality may also affect the performance of MFIs as has been suggested by Cull or Kar (2011), represented by Portfolio at Risk for loans that have been due for 30 days, or PAR $>$ 30 days, and write off ratio. Write off ratio represents *ex post* situation where the MFIs have recorded the loans as default.

The other group of independent variables are control variables. They are age, to control effects of age of the MFIs to the models, next is the differences in respective regions where MFIs are located, differences in legal status of IMFIs and finally differences in profit orientation of the MFIs (non-profit vs for-profit). These variables have been used in existing literature, especially Cull *et al.* (2007) and Kar (2011).

6. Result and discussion

Regression results from the model demonstrate that IMFs are enjoying higher outreach to the poor as indicated by significantly positive *Log_NAB*, despite operating at a lost as indicated by negative ROA. Further discussion on the result will be elaborated in the following subsections (Table III).

6.1 Analysis of regression results

This study explores the extent to which financing logic Islamic microfinance changes from the focus of financial objectives and development to focusing sustainability through only a few variables. The study finds that the estimated result of regression analysis is at satisfactory level where the R^2 is 0.913 for outreach and 0.198 for profitability. The results indicate that with the available data, Islamic microfinance in general is still working toward achieving their poverty alleviation mission, as their scale of outreach or *Log_NAB* is significantly positive, while ROA is negative.

Key determinants of higher or positive outreach (*Log_NAB*) are ROA (–), average loan size per Gross National Income (–), cost per borrower (–), size in terms of total assets (+), age_mature or IMFIs that have been around more than eight years (–) and regional indicators (+). Likewise, significant determinants for ROA model are outreach indicator or number of active borrowers (–), average loan balance/size (+), cost per borrower (–), write

Variables	*Log_NAB* (Outreach)	ROA (Profitability)
Mfitype_Islamic	*0.285**** (0.067)	−0.009 (0.017)
Return on assets	*−1.221**** (0.183)	
Log_NAB		*−0.024**** (0.005)
Yield on GLP_real	−0.140 (0.095)	−0.012 (0.012)
Avg_loan balance per borrower GNI	*−0.027** (0.013)	*0.001*** (0.000)
Percent of female borrowers	−0.000 (0.061)	−0.007 (0.009)
Log_CPB	*−0.825**** (0.029)	*−0.050**** (0.007)
PaR_30days	−0.074 (0.151)	−0.059 (0.041)
Write off ratio	0.656 (1.069)	*−0.356**** (0.090)
Log_Size	*0.924**** (0.008)	*0.027**** (0.006)
Age_mature	*−0.197**** (0.034)	−0.006 (0.004)
Age_new	0.037 (0.052)	*−0.029*** (0.010)
Region_EAP	*0.407**** (0.066)	*−0.053**** (0.008)
Region_MENA	*0.326**** (0.073)	*−0.026*** (0.008)
Region_SA	*0.258*** (0.093)	*−0.116**** (0.013)
Legal status_bank	0.057 (0.049)	−0.002 (0.007)
Legal status_ngo	0.055 (0.043)	0.008 (0.007)
Profit status_non	−0.022 (0.040)	*−0.013** (0.006)
Constant	−1.722*** (0.207)	0.121*** (0.025)
Observations	2,003	2,003
Adj. R^2	0.913	0.198

Notes: Robust standard errors in parentheses. *$p < 0.05$; **$p < 0.01$; ***$p < 0.001$

Table III.
Estimated results of regression

off ratio (−), size (+), new MFIs or age_new (−) and regional indicators as well as non-profit oriented status (−).

Negative relationship between ROA and *Log_NAB* in both regressions suggest that there is a trade-off between profit and outreach. This relationship is consistent with mission drift argument, although there is not sufficient evidence to suggest the presence of mission drift. The other important relationship in the results is size and age. The results suggest that larger IMFIs or those with higher total assets will have more capacity to increase outreach, hence a positive and significant relationship. Size is also important to generate profit for MFIs, as indicated by significantly positive relationship between ROA and *Log_Size* in ROA regression.

Further, average loan balance per borrower GNI has a significantly positive effect on profitability while significant negative effect on NAB. *Log_CPB* has significantly negative effect on both outreach and profitability. The size of microfinance institution has a significantly positive influence on both NAB and ROA. The results are similar to those of Rahman and Mazlan (2014) and Rahman and Mazlan (2014), which show that size has a significantly positive influence on the ROA (sustainability) of IMFIs. The effect of size on outreach (NAB) is greater than profitability. It indicates greater size of microfinance will affect greater outreach than profitability.

The age of microfinance institution has a significantly negative effect on outreach and has no significant effect on ROA. It means, the older the IMFIs the less outreach that they will achieve, i.e. they focus more on sustainability. However, this is not proven in the ROA regression where age is negative and not significant. According to Fersi and Boujelbéne (2016), using data 1996 to December 2012, age has a significant and positive influence on social performance in Islamic microfinance. The difference may be due to the time difference of the sample. It indicates that in period of data set taken in this study, the social orientation of microfinance institution is decreasing.

Region_EAP (East Asia Pacific) has a significantly positive impact on outreach while significantly negative affect the ROA. It shows that IMF in EAP region has small ROA while the Middle East and North Africa (MENA) region has a significantly positive influence on outreach and it has significantly negative effect on profitability. Region_SA (South Asia) has a significantly positive effect on outreach while it has a significantly negative effect on ROA. However, of the three regions that have the largest positive and significant impact on outreach is East Asia Pacific with a value of 0.407. While for the region that has the greatest negative impact and significant to ROA is South Asia with a value of 0.116.

Moreover, the regression result also reveals that size, Region_MENA, Region_SA, Region_EAP has a significantly positive influence on outreach while loan balance, age mature and *Log_CPB* have a significantly negative effect on outreach. For profitability, the regression results state that loan balance, size have significantly positive toward profitability (ROA) while *Log_CPB*, Write off ratio, Age_new and all regions have significantly negative influence on profitability.

6.2 Analysis of vision and mission statements of IMFIs

From 25 observations, most of the IMFIs state that poverty alleviation is still their primary objective, although many also attempt to ensure sustainability of its mission. For instance, MBK Ventura states in its website that its current mission is as follows:

> MBK's vision to improve the lives of significant numbers of households who find themselves at the bottom of 25% of the population by income in Indonesia. Its mission is to provide access to formal and cost-effective working capital to significant numbers of low income women who are unbanked at the moment, particularly in rural areas and small town, in an earnest, fair and efficient manner.

MBK also describes its vision that hopes to meet MDGs particularly in fighting poverty and empowering women. MBK Ventura and similar minded IMFIs recognize both poverty alleviation and sustainability objectives, hence their emphasis on "formal and cost-effective" loans to "low-income women who are un-banked." From the beginning, MBK was established as a private and limited liability company with a license as venture capital-company from the regulators. In a way, it is a commercial non-bank financial institution dedicated to providing working capital or loans to the poor, and not allowed to mobilize savings.

This mission seems to be shared by other IMFIs (see details in Table AI), with some exceptions. Akhuwat for example is a non-governmental organization and managed mostly, if not entirely, by volunteers. Its main mission is poverty alleviation and jobs creation. There is no mention in its website on funding or operational sustainability, let alone profitability. Its mission is as follows:

> To alleviate poverty by empowering socially and economically marginalized families through interest free microfinance and by harnessing entrepreneurial potential, capacity building and social guidance.

On the other hand, there are also IMFIs that adopt financial strength or sustainability as their primary mission. Among such organizations include Islami Bank Bangladesh whose vision is entirely commercial, as follows:

> Our vision is to always strive to achieve superior financial performance, be considered a leading Islamic Bank by reputation and performance.

The only explanation for this is the nature of the institution as a bank, although majority of its portfolio is in the microfinance sector. This support the organizational pursuit of profitability especially with the emphasize of financial performance.

In a broader context, the microfinance industry is growing while undergoing a transformation from donor driven and social framework toward an exposure to commercial-based funds, including certain degree of capital market involvement. This change is caused by many factors, e.g. diminishing donation and getting harder to find, as well as emerging possibilities of profitability for most MFIs (Im and Sun, 2015).

Likewise, Nasution and Ahmed (2015) suggest that due to sustainability issues IMFs cannot rely only on charitable funds. It is important for IMFIs to explore other sources of funding. Though this will pressure microfinance institution to effectively manage its cost of fund, the downside will be the return consideration extending this fund to the risky members of society. It is in this situation that consideration for profitability becomes stronger, that it is a proper mechanism for achieving long-term viability and sustainability of the Islamic microfinance industry (Ibrahim *et al.*, 2016).

In addition, Rahman *et al.* (2015) find that funds from the government and private donors have not been able to significantly reduce poverty. The gap can only be filled through a substantial increase in self-sustaining and profitable MFIs. Further, profit orientation by IMFIs could also increase the independence of their clients, as they are being monitored more closely by the MFIs.

7. Conclusion and recommendation of future research

This paper attempt to explore instances of shift in the mission of IMFIs by examining trade-off between poverty outreach and sustainability, primarily as the result of continuous use of financial criteria (or logic) in their performance measurement. After analyzing regression results as well as visions and mission of select IMFIs, the study finds that there is no strong evident to suggest that Islamic microfinance has abandoned poverty mission. Although most of the IMFIs are adopting dual missions or poverty alleviation and attaining sustainability, they remain committed to their original mission of helping the poor. This is admirable as the establishment of IMFIs is to assist the unfortunate members of the society rather than being profit driven.

However, the results also indicate that few IMFIs are already moving toward sustainability as their main goals, which prove the existence of both financial and development logics in the Islamic microfinance context. This is consistent with the argument of Arun and Hulme (2009) that both financial logic and social logic do exist within microfinance institutions, which pose some serious management dilemmas. The coexistence of both competing logics in the running of IMFIs may cause a rift and victimise the borrower resulting them to fall deeper into poverty. The analysis of visions and missions of the institutions indicates that this is the prevailing case. Such dilemma opens up a gap to further inquire on the commercialization of microfinance whether the end game is to attain profitability in the inclusion of the poor into the financial system through microfinance schemes. Acknowledging the data sets and period concerns, it would be an opportunity to reapply the same study for the period of 2018 above, as the United Nation has been actively socializing the sustainable development goal, which includes eradication of poverty. This may put pressure to MFIs generally and IMFIs specifically to realign them to their initial objective to assist the poor.

The results from this study would be useful for MFIs and regulators to monitor and avoid the occurrence of trade-off or mission drift, i.e. abandoning poverty mission in the exchange of higher profitability or sustainability. Considering governance of microfinance, policy makers can re-evaluate the effectiveness of the microfinance schemes especially in the quest to eliminate poverty within their respective jurisdiction. This paper has identified areas of concern for shareholders, in particular cost of serving borrowers for IMFIs. The result shows that cost is significantly negative for both outreach and sustainability, or it adversely affect both objectives of poverty alleviation and sustainability. Hence, ensuring efficiency is paramount for IMFIs, which requires regulators and other stakeholders to play critical role.

The other important factor is size. The result of this paper seems to suggest that, as IMFIs are getting larger they would be able to maintain higher poverty outreach and at the same time profitability. It implies that larger IMFIs are ideal and would serve the dual purposes of poverty alleviation and profitability for microfinance institutions. However, as majority of IMFIs are small in size, the challenge is how to up-scale these institutions, or else improve their outreach and efficiency.

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Appendix

Table AI.
IMFIs visions and missions

No	Institution	Establishment	Vision	Mission
1	IIFC – Islamic Investment and Finance Cooperatives (Afghanistan)	2009	n/a	To provide quality technical assistance to the IIFCs in Afghanistan To build the capacity of the staff working at the IIFCs To do fundraising for the IIFCs To regulate and supervise the operations of the IIFCs To launch advocacy and conduct lobbying on behalf of the IIFCs
2	Mutahid (Afghanistan)	2011	To be a world-class financial services organization that provides products and value-added services to the economically challenged, helping them generate higher incomes, build an asset base and achieve a sustainably better standard of living	Mutahid Development Finance Institution mission is to offer financial services to, and create opportunities for, Afghan entrepreneurs, through an operationally self-sustainable, innovative, development finance institution
3	FINCA (Afghanistan)	2004	To build a global network of sustainable and scalable social enterprises that improve lives worldwide	To alleviate poverty through lasting solutions that help people build assets, create jobs and raise their standard of living
4	Family Bank (Bahrain)	2008	Providing good and varied financial services available to the poor and economically active in their location and in accordance with their circumstances, contributing to improving their living conditions and enabling them to contribute effectively to development	Provide continuous financial services that meet the requirements of the poor in terms of simplified and flexible procedures, easy guarantees, geographical presence and appropriate pricing to enable the poor to engage in economic activities that will bring them out of poverty
5	Muslim Aid Bangladesh	1991	Our vision is the alleviation of poverty, education for all, and for the provision of basic amenities for those in need; in order to create a world where charity and compassion produce justice, self-reliance and human development	Muslim Aid, a premier British Muslim relief and development agency, guided by the teachings of Islam, endeavours to tackle poverty and its causes by developing innovative and sustainable solutions that enable individuals and their communities to live with dignity and by supporting initiatives that promote economic and social justice
6	Islami Bank Bangladesh	1983	Our vision is to always strive to achieve superior financial performance, be considered a leading Islamic Bank by reputation and performance	To establish Islamic Banking through the introduction of a welfare oriented banking system and also ensure equity and justice in the field of all economic activities, achieve balanced growth and equitable development in

(*continued*)

No	Institution	Establishment	Vision	Mission
				through diversified investment operations particularly in the priority sectors and less developed areas of the country To encourage socio-economic upliftment and financial services to the loss-income community particularly in the rural areas
7	Islamic Relief Bangladesh	1991	We envisage a caring world where communities are empowered, social obligations are fulfilled and people respond as one to the suffering of others	Exemplifying Islamic values, Islamic Relief will mobilise resources, build partnerships, and develop local capacity, as the organizations works to: Enable communities to mitigate the effect of disasters, prepare for their occurrence and respond by providing relief, protection and recovery. Promote integrated development and environmental custodianship with a focus on sustainable livelihoods. Support the marginalized and vulnerable to voice their needs and address root causes of poverty
8	Prva Islamska Mikrokreditna (Bosnia Herzegovina)	2001		To help many BiH citizens improve their living standards
9	BMT Ventura (Indonesia)		Become the main player of financial services for micro, small and medium enterprises through BMT network	Participate and realize productive society Utilize investment to develop micro, small and medium entrepreneurs so that investment is more productive Participate in developing and developing sharia economic system Encourage the creation of superior performance BMT Utilize investment to develop micro-entrepreneurs
10	MBK Ventura (Indonesia)	2006	To improve the lives of significant numbers of households who find themselves at the bottom of 25% of the population by income in Indonesia	To provide access to formal and cost-effective working capital to significant numbers of low-income women who are unbanked at the moment, particularly in rural areas and small town, in an earnest, fair and efficient manner

(*continued*)

Table AI.

Table AI.

No	Institution	Establishment	Vision	Mission
11	Al-Takadum (Iraq)	2007	Serving communities through strategies for delivering locally acceptable loan products, filling an unmet market gap by larger players	n/a
12	Al-Thiqa (Iraq)	2004	To participate in rebuilding Iraq's economy by providing transparent financial services to micro and small enterprises and low-income households in Iraq	n/a
13	FINCA (Jordan)	2007	To be an unconventional community-based bank that profitably and responsibly provides innovative and impactful financial services to enable low-income individuals and communities to invest in their futures	To alleviate poverty through lasting solutions that help people build assets, create jobs and raise their standard of living
14	START Microfinance (Jordan)	n/a	n/a	n/a
15	Al-Majmoua (Lebanon)	1994	Our vision is to be the leader in creating an inclusive financial system where all people in Lebanon have access to affordable services	Our mission is to promote sustainable development by improving the economic and social conditions of low-income individuals, especially micro-entrepreneurs and women, through the provision of financial and non-financial services, all over Lebanon
17	Amanah Ikhtiar Malaysia	1987	To be complementary agents of poverty eradication programs of the Government under the National Development Policy	
18	Ukhuwat (Pakistan)	2001	A poverty free society built on the principles of compassion and equity	To alleviate poverty by empowering socially and economically marginalized families through interest free microfinance and by harnessing entrepreneurial potential, capacity building and social guidance
19	Wasil (Pakistan)	1992	Economic Empowerment through Islamic microfinance	To support the poor break out of the poverty cycle by providing them with Islamic financial services, business development services, advocating their rights, safety nets and skills training
20	Family Bank (Sudan)	2008	Providing good and varied financial services available to the poor and economically active in their location and in accordance with their circumstances, contributing to	Provide continuous financial services that meet the requirements of the poor in terms of simplified and flexible procedures, easy guarantees, geographical

(*continued*)

No	Institution	Establishment	Vision	Mission
			improving their living conditions and enabling them to contribute effectively to development	presence and appropriate pricing to enable the poor to engage in economic activities that will bring them out of poverty
21	Pased (Sudan)	2000	n/a	To improve the livelihoods of the low-income segments of the economically active people through increased access to financial and non-financial services in a sustainable manner and in line with the good practices
22	Jabal al-Hoss (Syria)	2000	n/a	To finance employment-generating small and micro enterprise
23	Al Amal (Yaman)	2009	To offer inclusive financial services for all Yemenis	To improve the economic and social conditions of the Yemeni low/limited income households, particularly, the micro and small entrepreneurs of Yemen, through the direct and indirect provision of exemplary financial services that suit their needs and to become a pioneer and sustainable microfinance institution
24	Bab Rizq Jameel (Egypt)	2003	We aspire to give everybody the chance to help to build a better world	We give people the power to improve their lives and the lives of those around them
25	Abyan (Yemen)	2003	Improve the income of the poor families in Abyan governorate specially women through introducing financial services for the clients	n/a

Source: Websites of each MFI

Table AI.