THE MEDIATING INFLUENCE OF ENTREPRENEURIAL EMPOWERMENT ON THE LINKAGE BETWEEN ISLAMIC MICROFINANCE SERVICES AND CLIENTS’ WELL-BEING IN MALAYSIA: PERCEIVED ASSESSMENT OF SERVICE PROVIDER

ABUBAKAR SADIQ USMAN

UNIVERSITI TUN HUSSEIN ONN MALAYSIA
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ABUBAKAR SADIQ USMAN

A thesis submitted in fulfilment of the requirement for the award of the Doctor of Philosophy in Technology Management

Faculty of Technology Management and Business

Universiti Tun Hussein Onn Malaysia

MAY, 2017
DEDICATION

I dedicate this thesis to the members of my family:
Aishatu Adamu Usman
Jamila Abdulhamid
Muhammad Kabiru Salihu
Sulaiman Musa Kabo
Abdurrahman Abubakar Usman
Muhammad Abubakar Usman
Maryam Abubakar Usman

This is in recognition of their myriad perseverance during my long absence. I love you all and my Allah bless our lives.
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My Allah reward everyone in the best of ways.
ABSTRACT

Understanding clients’ well-being from the perspective of service provider is important in Islamic microfinance services. The objective of the study was to examine the relationship between Islamic microfinance services with entrepreneurial empowerment and clients’ well-being. Three research questions and seven hypotheses were formulated to guide the study. The study covered within peninsular Malaysia. The sample was chosen from east coast states of Malaysia (Pahang, Terengganu and Kelantan states) because these states attracted more than 50% of funds disbursement by Amanah Ikhtiar Malaysia (AIM). The study population was 400, defined as a group of employees of Amanah Ikhtiar Malaysia (AIM) who are directly involved in the delivery of Islamic microfinance services. This comprised of branch manager and nine (9) members of staff from operations department in each of the 40 branches in the region. The sample for the study was 291 survey respondents from these staff of Amanah Ikhtiar Malaysia (AIM). A structured questionnaire consisting of closed-ended multiple choice questions was presented to the respondents, selected by a stratified and simple random sampling. Exploratory factor analysis (EFA), confirmatory factor analysis (CFA) and Analysis of Moment Structures (AMOS) were used to test the validity and reliability of the conceptual research model. The survey results supported four hypotheses, confirming that Islamic microfinance services have positive relationship with entrepreneurial empowerment. The results rejected three hypotheses on the relationship between Islamic microfinance services and clients’ well-being. The unique finding of the study is that, it has espoused the importance of entrepreneurial empowerment as a full mediator towards achieving clients’ well-being. The researcher concludes that Islamic microfinance services can improve clients’ empowerment and well-being by emphasising human, physical and social capital development.
ABSTRAK

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<td>AIM</td>
<td>Amanah Ikhtiar Malaysia</td>
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<td>AMOS</td>
<td>Analysis of Moment Structures</td>
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<tr>
<td>CFA</td>
<td>Confirmatory Factor Analysis</td>
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<td>EFA</td>
<td>Exploratory Factor Analysis</td>
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<td>GDP</td>
<td>Gross Domestic product</td>
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<td>GFDR</td>
<td>Global Financial Development Report</td>
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<td>GIFR</td>
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<td>Millennium Development Goals Report</td>
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<td>New Development Policy</td>
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<td>New Economic Model</td>
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<tr>
<td>NEP</td>
<td>New Economic Policy</td>
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<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
</tr>
<tr>
<td>OIC</td>
<td>Organization for Islamic Conference</td>
</tr>
<tr>
<td>PCA</td>
<td>Principal Component Analysis (PCA)</td>
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<td>SDGs</td>
<td>sustainable Development Goals</td>
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<td>SEM</td>
<td>Structural Equation Modelling</td>
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<td>SPSS</td>
<td>Statistical Package for Social Sciences</td>
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<td>UNDP</td>
<td>United nation Development Program</td>
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CHAPTER 1

INTRODUCTION

1.1 Background

There are glad tidings in the Millennium Development Goals Report (MDGR) in 2015 on the successes recorded in the fight against poverty. According to the MDGR (2015), the number of people living in extreme poverty has declined from 1.9 billion in 1990 to 836 million in 2015. Similarly, the number of people in the working middle class (living on more than $4 a day) has almost tripled between 1991 and 2015. This implies that as the basic sustenance is achieved, more focus will be needed towards wider dimensions of well-being. This is essential because yet still, a sizeable portion of humanity are still languishing in poverty most especially the less privileged by virtue of physical disability, gender and ethnic groups (Raimi et al., 2013). There are genuine concerns that this vulnerable group lacks opportunities necessary to live a valuable live. This has stimulated diverse interests from governments, donor agencies, private investments and the academia to find a solution to this menace. With about a quarter of world population and much of which lives in extreme economic conditions, Muslim countries have a major task on achieving acceptable well-being (Rahman, 2013; Mohieldin et al., 2011). Some of the difficult challenges facing these countries are how to improve productivity and quality of life of its citizens.

Malaysia is a multi-ethnic country that comprises the Bumiputera (Malays and other minority indigenous ethnic groups), Chinese and Indians. Successive governments have embarked on a range of national development policies such as the New Economic Policy (NEP) 1970-2000, the New Development Policy (NDP) 1991-2000 and the New Economic Model (NEM) 2010. The policies aimed at increasing income and productivity, with sustained rapid growth to attain the status of a fully
developed nation by 2020. Table 1.1 below presents the statistical results on the incidence of poverty over a period of four (4) decades.

### Table 1.1 Incidence of Poverty (% of pop): Malaysia 1970-2012

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<td>Incidence (%)</td>
<td>49.3</td>
<td>29.2</td>
<td>17.1</td>
<td>8.9</td>
<td>5.7</td>
<td>3.8</td>
<td>1.7</td>
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Table 1.1 represents poverty incidences in terms of percentage of the Malaysian population. The steady economic growth enjoyed in the last four decades resulted in a continuous decline trend in the incidence of poverty from 49.3% in 1970 to 1.7% in 2012.

The growing urgency for sustainable development globally has led to the idea for inclusive strategies gaining ground. This suggest that, to promote a balanced and equitable growth, the poorer section of the society has to partake meaningfully in the economy (Mohieldin *et al.*, 2011). Microfinance models are used in different countries to achieve entrepreneurial empowerment of the poor people and improve their lives. The Grameen bank founded by Muhammad Yunus is the famous model replicated in many countries, including Malaysia. According to Global Islamic Finance Report (GIFR) (2012), the providers of microfinance services in Malaysia are Microfinance institutions, Cooperative societies, Development financial institutions and Commercial banks with microfinance schemes. Among all the service providers, Amanah Ikhtiar Malaysia (AIM) is seen as the most successful replication of the Grameen model (Al Mamun, Adaikalam & Abdul Wahab, 2012; Omar, Noor & Dahalan, 2012). Amanah Ikhtiar Malaysia (AIM) offers micro-credit, micro-saving and welfare fund, and it has earned 99.2% loan repayment rate (Al-Shami *et al.*, 2014). The objective of microfinance intervention is to compliment government efforts in empowering the poor people to take advantage of the opportunities in the society.

Several studies such as Noreen (2011); Nurzaman (2011); Md Saad (2010) have indicated the role played by microfinance in enhancing entrepreneurial capacity of its clients. Entrepreneurial empowerment is the development of assets and capabilities of individuals and groups to engage, influence and participate in decision
making that shapes their lives (Bennett 2002). Narayan-Parker (2002) added that this empowerment entails self-strength, self-power, self-reliance and life of dignity. The aim of Islami microfinance services (micro-credit, micro-saving and charity and welfare fund) is to enable its clients to have such assets and capabilities so as to develop their micro enterprises. Putnam (2000) argued that for a proper development, empowerment must have human, physical and social dimensions. This is necessary to meet the requirement for entrepreneurial empowerment. Human capital refers to the properties that an individual has (education, skills and knowledge), physical capital entails ownership of physical or environmental resources (physical assets) and social capital means social support and integration (networks and connections). Furthermore, these components of entrepreneurial empowerment are similar to the three dimensions of development in Islam. According to Mohieldin et al. (2011), individual self-development, physical development, and development of the humans toward full integration and unity are the scope of the Islamic concept of development.

Assets empowers people to withstand shocks and expand their choices, while capabilities enables them to use their assets in different ways. Islamic microfinance services are designed to offer opportunities to the clients in terms of training, financial literacy, assets acquisition and mutual cooperation. This suggest that, entrepreneurial empowerment and clients’ well-being are important ends because entrepreneurial empowerment is necessary in building the clients’ capability, which is crucial for them to achieve a worthwhile life.

Emerging trend in microfinance in Malaysia focuses on offering more services to improve both financial and non-financial well-being of the clients. This concept on wider dimension of well-being is in line with developmental objectives of nations and was also adopted by the United Nations’ Sustainable Development Goals (SDGs) (Sachs, 2012). The Capability Approach espoused the importance of functionings to live a valuable life. This idea suggests that, the poorer sections of the society must be helped to enhance their capabilities so that they can join mainstream society and have a decent life (Mohieldin et al., 2011; Nair, 2010). This is essential because human efforts, skills, talents, as well as need for income generation, asset acquisition and protection against risk are necessary for promoting and sustaining economic growth (Anand & Sen, 2000). In order for the vulnerable people to attain their full potentialities, their conditions have to be improved towards freedom and independence. According to Rath & Harter (2010) and McCarthy (2010), a thriving
life could be distinguished from one spent suffering based on career, social, financial, physical, community dimensions. The Organisation for Economic Co-operation and Development (OECD) has also proclaimed that, how people think about and experience their lives is an important component of society’s progress.

There are indications from the literature review that, to understand the real contribution of microfinance, evaluations must embrace range of services on a wider well-being scale. To determine how microfinance can be used as a strategy for a critical contribution to emerging challenges in Malaysia, it will require a careful research and articulation. It is noteworthy that the impact of economic growth is essential in creating opportunities and raising the standard of living and in fact one of many conditions for poverty reduction (Ravallion & Chen, 2009; Foster & Székely, 2001; Ravallion & Datt, 1999). However, the approach in this study does not believe that the gains from increased growth automatically trickles down to the poorest. Rather, economic policy instrument may be needed to distribute the growth to the benefit of people at all societal levels. This means that there is need to prove that microfinance intervention results in improvement of well-being in terms of career growth, financial and social growth for its clients (Michaelson, 2012; Rath & Harter, 2010). According to Anand & Sen (2000); Nussbaum & Sen (1993), welfare improvement is one of the objectives of economic development and necessary for a balanced economic development. This research seeks to study what phenomena maintains the gap, and what tools should be used to close the gap.

Appraising such intervention is important to justify the huge investments in them and also to assess whether they meet the requirements of the targeted beneficiaries. Determining the impact of such interventions will answer the question of whether microfinance has a role in its clients’ well-being in spite of the general economic growth in Malaysia. This may help Malaysia to achieve a high income nation by the year 2020.

1.2 Statement of research problem

The need for this study arises from the Malaysia Well-being Report (MWR) 2013 which analyses the effectiveness of the government’s various socio-economic development policies in improving the well-being of the people. The MWR 2013
acknowledged the remarkable achievements in terms of economic growth, it has also highlighted on the less impressive record in income distribution in rural-urban and across ethnic groups. Table 1.2 presents the incidence of rural and urban poverty statistics.


<table>
<thead>
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</thead>
<tbody>
<tr>
<td>Rural</td>
<td>58.7</td>
<td>24.7</td>
<td>15.6</td>
<td>13.2</td>
<td>11.9</td>
<td>8.4</td>
<td>3.4</td>
</tr>
<tr>
<td>Urban</td>
<td>21.9</td>
<td>8.2</td>
<td>4.1</td>
<td>3.8</td>
<td>2.5</td>
<td>1.7</td>
<td>1.0</td>
</tr>
<tr>
<td>Disparity</td>
<td>2.68</td>
<td>3.01</td>
<td>3.8</td>
<td>3.47</td>
<td>4.76</td>
<td>4.9</td>
<td>3.4</td>
</tr>
</tbody>
</table>

According to the results in Table 1.2, while incidence of poverty has drastically declined from 58.7% in 1970 to 3.4% in 2012 for rural, and from 21.9% in 1970 to 1% in 2012 for urban. However, disparity in terms of rural - urban has worsened. The disparity between rural-urban was 2.68 in 1970 but increased to 3.4 in 2012. In other words, the steady economic growth over the last four decades has the following implications:

- Decline in the incidence of poverty.
- Galloping trend over a period of four decades.
- Disparity in rural-urban economic development.
- Depict poverty as a rural phenomenon.

This means that although high economic growth has been recorded in the last four decades, it indicates an unbalanced proportion in rural-urban economic development and has made the gap of inequality in incomes a reality. Similarly, besides the rural-urban disparity, there is also an ethnic dimension of income inequality. Figure 1.1 presents distribution of household income across ethnic and strata lines.
From Figure 1.1, the income distribution is shown for each segment of the population from 2004 – 2012. It indicates that Bumiputera who are the largest ethnic group has the lowest average household income at 4,454 in 2012, compared with Chinese and Indians who have average household income of 6366 and nearly 5,533 in 2012 respectively. Similarly in 2012, the rural dwellers (3,080) have a half average household income when compared with urban citizens who have 5,742. It is noteworthy that extreme poverty has been reduced to 1.7% in 2012 (based on Table 1.1), yet the disparity in incomes between urban-rural and among the ethnic strata persists. In 1999, Malaysia has had the highest income disparity in the Asia Pacific region with an income disparity ratio of 11.7% between the richest 20% and the poorest 20% of the population (Nair, 2010).

According to Henderson et al. (2002), this disparity is attributed to the fact that the Bumiputera has the majority population that lives in the rural areas and lacks capacity-building. Another reason for this disparity may be the policies that supports the development of infrastructure, mobility and communication for urban growth (Suri et al., 2011; Ang, 2010; Fleisher, Li & Zhao, 2010; Shahbaz, 2010). Such policies isolates rural areas and hinders their integration with urban society, established markets and access to capital, and this could impede human progress and development (Raimi et al., 2013; Foster & Székely, 2001; Gallup, Radelet & Warner, 1998).
Inequalities in socio-economic status and income heightens vulnerability of the poor people despite successes in economic growth (Prabhakar et al., 2015).

The concerns of the MWR 2013 is that, understanding of well-being is important in assessing development. To achieve a meaningful development in the society, the economic gains must be seen to improve financial and non-financial dimensions of well-being of all citizens especially the poor people. Welfarism which is centred on resources assesses well-being only in terms of subjective utility (what a person feels) but neglects information about physical health and social relationships. This method is vulnerable to ‘adaptive preferences’ when people can become so normalized to their poor conditions that they may claim to be entirely satisfied (Wells, 2012). Similarly, the perspective of the previous studies on assessing clients’ well-being adopted the Welfarism approach, and was centred on the view of the clients using impact assessments. This reduced many of such studies with partial or contested impacts because of the difficulty to proof that causality is a direct consequence of the microfinance intervention (Epstein & Crane, 2005; Hulme, 2000; Mosley, 1997). The predicaments of the clients have affected their standing and ability to offer relevant information about their conditions. Low levels of education and sophistication are deterrents for them to appreciate key issues with respect to their socio-economic circumstances.

In order to avoid such dilemma, a quantitative approach that seek responses from the service provider is needed so as have a general view on clients’ well-being. While a client will only tell about his or her subjective well-being, a service provider can give a general over-view of clients served. For service providers to achieve long term growth and sustainability, they must have visibility and a bird’s eye view of the condition of their clients in order to have a better analyses to improve on offering strategic services. This is expected to address clients’ needs and improve service quality which eventually would serve the well-being of the clients.

The emerging challenges in Malaysia has made it necessary to investigate the impact of microfinance on its clients’ well-being. Most previous studies are characterized with making emphasis on social and financial exclusions of the poor. They argue that wider access to micro-credit could bring improvements in human capital development, education and skills development, better provision of physical capital (Syed Ali, Shirazi & Nabi, 2013; Mohieldin et al., 2011; Obaidullah & Latiff, 2008). Some of the studies indicates that, such entrepreneurial empowerment leads to
improvement in the well-being of the poor people (Al Mamun, Adaikalam & Abdul Wahab, 2012; Omar, Noor & Dahalan, 2012; Bhuiyan et al., 2011; Md Saad & Duasa, 2010; Nawai & Bashir 2009). The argument based on the Amartya Sen’s Capability Approach suggests that, understanding the socio-economic conditions of the poor goes beyond resources, income or utility. It includes other abilities, functionings and freedom of choice, to appreciate a valuable life.

To achieve entrepreneurial empowerment for the clients, there is need to develop their human, physical and social capacity (Newman, Schwarz & Borgia, 2014; Roomi, 2013; Putnam, 2000). Some studies such as Usman & Tasmin (2016b); Shirazi (2012); Noreen (2011); Nurzaman (2011) Md Saad (2010) have confirmed the significance of Islamic microfinance services in enhancing the entrepreneurial capacity of the clients.

A critical review of the literature shows that, despite the diverse entrepreneurial needs of the clients, a vast proportion of the literature ignores other entrepreneurial deficiencies that also affect the capacity and well-being of the clients. More so, the studies are not tailored in a way that may broaden our conception of wider dimensions of well-being such as career growth, financial and social growth of the clients. This may affect the nature and content of well-being service delivery to the clients (Bebbington, 1999). Human needs are diverse whereby when one is satisfied another set of need is yearned for (Deci & Ryan, 2008). This implies that, the freedom to live a valuable life depends on a variety of factors, including personal characteristics and social goals. Being well-fed, literate, skills and assets development, self-reliance and communal services constitute an important part of individual freedom (Gough, 2014; Sen, 1993).

The concerns highlighted above have necessitated a study to address the diverse needs of the clients towards entrepreneurial empowerment and well-being in a comprehensive way. While it is important for microfinance services to empower the entrepreneurial capacity of the clients, it is equally essential to see how such entrepreneurial empowerment can translate to well-being improvement. In order to address the well-being measurement gap, this study examined the mediating influence of entrepreneurial empowerment in the linkage between Islamic microfinance services and clients’ well-being from the perspective of Amanah Ikhtiar Malaysia (AIM).
1.3 **Significance of the study**

This study is based on theoretical as well as empirical observations, and is distinctive because of the following reasons:

1) It investigated the diverse deprivations of the poor in a comprehensive way, for instance the need to generate income, the need to save for expansion and assets building, and the need for protection against future risks.

2) The study used a wider measurement of well-being that involved both economic and noneconomic dimensions, for instance career growth, financial growth and social growth.

3) The study investigated the importance of entrepreneurial empowerment in Islamic microfinance service delivery.

4) This study used a service provider perspective based on their experiences over the years.

This investigation is essential because it would ensure that research and development efforts are aligned to the accomplishment of national growth objectives (Xavier & Ahmad, 2012). Similarly, providers of microfinance services will want to know the services that influence their clients’ well-being so as to tailor service delivery and encourage the general development of their offering (Saad, 2012). This is expected to generate improvements, and both policy makers and finance managers require information about the impact of their programs on the target beneficiaries so as to build stronger relationships with them. Furthermore, undertaking investigation on the effect of Islamic microfinance services on empowerment and well-being could enrich research centres, improve the standard of research, and earn Malaysia a wider recognition in the area of Islamic microfinance globally. This will also have a great significance on customer service delivery since the providers would strive for quality in their services. It can also be considered essential for success in today’s highly competitive world of business, as it has a direct effect on performance and changing the well-being of the target beneficiaries.
1.4 Objectives of the study

Specifically, the objectives of this study are:

1. To examine the relationship between Islamic microfinance services and entrepreneurial empowerment in Malaysia.
2. To examine the relationship between Islamic microfinance services and clients’ well-being in Malaysia.
3. To examine the mediating effect of entrepreneurial empowerment in the relationship of Islamic microfinance services and clients well-being.

1.5 Research questions

The central research question guiding this study is:

What is the linkage between Islamic microfinance services and clients’ well-being in Malaysia?

To address the above general question, data will be collected to answer the following specific research questions:

1. What is the relationship between Islamic microfinance services and entrepreneurial empowerment in Malaysia?

2. What is the relationship between Islamic microfinance services and clients’ well-being in Malaysia?

3. What is the mediating effect of entrepreneurial empowerment in the relationship between Islamic microfinance services and clients well-being in Malaysia?
1.6 Scope of the research

To achieve a meaningful coverage, this study covers peninsular Malaysia. The sample is limited to east coast region (Kelantan, Pahang and Terengganu states) owing to the fact that the region is less industrialized when compared with the west coast region (Henderson et al., 2002). According to the East Coast Economic Region (ECER, 2012) official estimates, the region covers an area of about 66,000 sq. km, (51% of the land area of Peninsular Malaysia) with a population of almost 3.9 million (14% of the total population of Malaysia), and is expected to grow to over 4.9 million by 2020. Part of the ECER Master plan over the next 12 years is to have a strong educational system towards a large pool of educated and skilled workforce who can drive technology and knowledge-based industries; with measures to eradicate poverty and improve incomes and distribution in a sustainable manner.

The sample was drawn from operational staff of Amanah Ikhtiar Malaysia (AIM), a pioneer and dominant microfinance service provider in Malaysia. Operational staff are selected based on the fact that they are in close contact with the clients and the strategies they adopt over the years. The east coast region, with an overall 14% of the population of Malaysia, but attracted more than 50% of funds from Amanah Ikhtiar Malaysia (AIM).

Table 1.3: Amanah Ikhtiar Malaysia: Funds/Membership/Branches (AIM, 2015)

<table>
<thead>
<tr>
<th>Region</th>
<th>Fund disbursement (%)</th>
<th>Clients’ membership (%)</th>
<th>Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northern</td>
<td>16</td>
<td>15.6</td>
<td>33</td>
</tr>
<tr>
<td>Central</td>
<td>3</td>
<td>8.4</td>
<td>14</td>
</tr>
<tr>
<td>East-coast</td>
<td>51</td>
<td>18.3</td>
<td>40</td>
</tr>
<tr>
<td>Southern</td>
<td>6</td>
<td>18.3</td>
<td>17</td>
</tr>
<tr>
<td>Sabah &amp; Sarawak</td>
<td>24</td>
<td>39.4</td>
<td>47</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>151</td>
</tr>
</tbody>
</table>

The study is limited to Amanah Ikhtiar Malaysia (AIM) and do not extend to other microfinance institutions or other lending institutions who do not offer Islamic microfinance.
1.7 Research structure

Research structure is an outline of how the study was planned such as the procedures, data collection techniques, statistical tools for analysis and reporting of data. The reporting covers contents discussed in various chapters of the research report. The research structure served as a useful guide to the researcher in the process of generating data for the study. For the purpose of this research, data regarding Islamic microfinance service and clients’ well-being was sought. Equally important is entrepreneurial empowerment which also influences the capacity of the clients. Data was collected using questionnaire. The data was analysed using a series of exploratory and confirmatory analysis presented in tabular form and descriptively discussed. Summary of findings, recommendations and conclusion are presented with suggestions for future studies.

1.8 Organization of the thesis

This thesis is organised in to six (6) chapters. The general introductory aspects of this study were discussed in chapter 1. The chapter comprises of background of study, statement of research problem, research questions, and objectives, scope of study and significance of the study. Relevant literature on conceptual framework and previous studies on the topic were reviewed and presented in chapter 2. Research framework development was also discussed in Chapter 2. These include theoretical framework development, human development theories, entrepreneurial empowerment measurement, and clients’ well-being measurement. Methodology of the study was discussed in chapter 3. It comprised of detailed explanation on population of study, sample and sampling technique, instruments of data collection, method of data presentation and analysis as well as justifications for using each method mentioned above. Descriptive data analyses on Islamic microfinance services, entrepreneurial empowerment and clients’ well-being were presented in chapter 4. Data analyses were conducted in three phases. The first phase examined respondents’ characteristics and descriptive statistics of study variables. The primary statistical assumptions were also tested. The second phase of data analyses involved a series of exploratory and confirmatory factor analyses to specify, test and revise the measurement models of the
study variables. The final phase of data analyses examined the simultaneous estimations of the measurement and structural models using structural equation modelling (SEM). Chapter 5 presented the results for modelling. SEM was used to evaluate effects of Islamic microfinance services on entrepreneurial empowerment and clients’ well-being. Discussion of results of findings, conclusion and recommendations appeared in chapter 6. The assessment of measurement and structural models and the analysis of the test results for the hypothesized relationships were also discussed in chapter 6. Furthermore, the chapter provided a summary of the research and concluded by discussing the contributions of the study, the theoretical and practical implications of the study, the limitations of the study and suggestions for future research.

1.9 Operational definition of terms

For the purpose of this research, the following terms are operationally defined in the context of the study as follows:

1. **Service provider**: An institution that specializes in providing microfinance services. In the context of this study, service provider refers to Amanah Ikhtiar Malaysia (AIM).
2. **Clients**: It is defined as persons that receives microfinance services as offered by the service provider to run their micro businesses.
3. **Operational staff**: These are members of staff of the service provider who are directly involve in the delivery of microfinance services and are in close contact with the clients.
4. **Islamic microfinance services**: These are interest-free micro-credit, micro-saving and charity and welfare fund that are offered to the clients with the aim of improving their living conditions.
5. **Micro-credit**: This is an interest-free micro loan given to the clients for the purpose of setting up a micro enterprise.
6. **Micro-saving**: This is a micro saving by the clients as a requirement by microfinance service provider.
7. **Micro-insurance**: This is a form of protection for the clients that requires them to pay a premium against unforeseen future risk
8. **Charity and welfare fund:** This is a form of protection for clients which is donated voluntarily as a mutual cooperation among the clients.

9. **Entrepreneurial empowerment:** This comprises of components of human, physical and social capital needed to build the capability set of the microfinance clients.

10. **Clients’ well-being:** An acceptable living condition for the clients of microfinance that comprises of career growth, financial and social growth.

### 1.10 Summary of the chapter

This chapter provides an overview of the thesis. The chapter begins by introducing the background and research problems of this study. This led to the development of research objectives. The contribution and significance of the study were subsequently discussed. Finally, a summary of the research structure, organisation of the thesis and operational definitions are provided.
CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

This chapter discusses the basic concepts and relevant literature on the study. It is organised in a way that simplifies the information flow on the study variables. The foundational issues about the subject matter were discussed first. This includes causes of poverty, poverty in Malaysia, social and financial inclusions. The chapter then explained the first and second dependent variables. Closely related to the concept of well-being is empowerment that helps to build entrepreneurial capital, was also examined. Literature on well-being and empowerment were reviewed including elements, measurements and relationships with Capability Approach. Justification for using such measures were explained. The foundation of Islamic microfinance, service providers, and the role of Islamic microfinance towards human and sustainable development were analysed. Relevant literature used in developing the constructs for Islamic microfinance towards clients’ well-being were discussed. There was an examination of the conceptual framework that guided this thesis and provided useful constructs from which to assess and evaluate the linkage of microfinance services and well-being of clients. The theoretical underpinnings of the study, giving justification on the relevance of Capability Approach to this study was also discussed. The Capability Approach was employed to understand the welfare measures and how it affects the microfinance clients. This theoretical perspective provided the structure within which this research was conceptualised and within which the various microfinance services were examined. A summary of relevant literature was outlined and a brief conclusion at the end of the chapter.
2.1.1 Poverty causes

The effects of poverty can be felt at every level of society, from the individual living in poverty to the political leader and donor agencies attempting to provide solutions. Whether it is health conditions, illiteracy or increased crime rates, it spreads to every aspect of life with physical, social and financial repercussions. The psychological consequences are devastating when the victims feel they have no response that can reduce the menace, and this results in unimagined outcomes that are detrimental to the society. While some researchers (the conservatives) blame the poor for their personal traits, others (the liberals) see this menace in the light of key social and economic failings. Bradshaw (2006) has summarised what causes poverty as follows:

- Individual deficiencies. This theory is based on the premise that opportunities are open for everyone to excel through hard work and determination.
- Socio-economic subculture. This theory suggests that the poor are kept in poverty as a result of maintaining certain attitudes, beliefs and perspectives.
- Structural explanation of poverty. Persistent inequity in the society in terms of distribution of power, wealth and other resources forces some to remain in poverty.
- Geographical disparities. Localization of industries in one area makes concentration of poverty in other areas for its inability to compete economically.
- Cyclical theory. Combining both individual and system causes to explain why some groups remain in poverty.

A summary of theoretical causes is presented in Figure 2.1.
Figure 2.1 above indicates that, causes of poverty are diverse, ranging from individual, systemic and cultural causes. However, these theoretical causes of poverty have been criticized for analysing the issues without the perspective of the poor. They have not allowed those who are experiencing poverty themselves to define what constitutes their basic necessities in life (Nair, 2010). According to Anand & Sen (2000), the individual deficiencies theory fails to recognize the abilities of people who are born with disabilities and unable to do something that can push them out of poverty. In reality, disabilities will only result in poverty when the individual concerned is not willing to do something to improve upon his or her condition. The socio-economic subculture explains how culture influences development because culture constitutes part of development. This indicates that people are poor because their values are embedded in personality traits which were acquired through the process of socialization. In order to tackle poverty in such an environment, there is need for value reorientation to enable them take the opportunities in the society (Akers, 2014). The structural theory focuses on the chances of people as determined by the social forces.
and circumstances such as economic growth, labour market opportunities and educational facilities. The structures that are in the society including the organisation of social relations such as race, gender, class and power determines the fate of people especially the vulnerable groups (Farrigan & Parker, 2012). However, in Islamic economics, poverty is not caused by scarcity of natural resources or production-distribution relation, but by waste, extravagance and unequal distribution in the society (Mohieldin et al., 2011).

Therefore, looking at poverty from diverse causes ensures a more effective poverty solution when compared to programs that addresses a single cause (Bradshaw, 2006). The idea of the Capability Approach remains relevant in understanding poverty because it is built on the basis that humans are basic ends and principal means of development. This approach strikes a balance between the blaming the victim and the structural inefficiencies theories. It sees development as a mutual relationship between the capabilities of citizens and the requirement of the system. The Capability Approach is adopted in this study to espouse the contribution of individuals as means and ends of development especially in the developing countries. One of the strategies used by governments and other donor agencies to give opportunities to individuals, especially the low income segment, is through microfinance. It is essential to review such intervention in the light of the Capability Approach.

2.1.2 Poverty in Malaysia

In all the development plans in Malaysia, the objective was economic prosperity through opportunities such as foreign direct investment, education and training, rural and infrastructural development. The goal was to generate income and productivity to raise the standard of living. It is pertinent to note that the export oriented economic model had provided Malaysia with unprecedented economic growth that is pivotal for national development. Under the New Economic Plan (NEP) 1970-1990 the economy grew at the rate of 6.7% per annum, while annual growth averaged 8.7%. During the National Development Plan (NDP) 1990-1995, real GDP expanded at an average rate of 8.7% per annum but later declining to 7.4% in 1998 (Nair, 2010). The resultant effect was that it has increased productivity and opportunities for citizens to gain employment in high paying jobs, enjoy quality products and improve living standard.
In all the developmental policies, education is held in high esteem especially to the Bumiputera that live in the rural areas. The employment opportunities created quality workforce and enhanced capacity building (Abhayaratne, 2004). Incentives were introduced to encourage citizens, for instance welfare for students, pre-school education, literacy and numeracy, improving the quality of schools. All these resulted in a steady decline trend of the incidence of poverty from 49.3% in 1970 to 1.7% in 2012 as indicated in Table 1.1.

However, in the NDP dispensation, the economic indicators displayed a mixed result. While GDP grew at the expected average annual growth of 7%, export of goods and non-factor services was at average annual growth of 12.4% against the targeted 6.3%, unemployment was down to 3.1% against the targeted 4%, but private investments were 3% average annual growth against the targeted 8%, public investment increased at an average annual growth of 10.5% against the targeted negative growth rate (Henderson et al., 2002).

The effect of these policies are the achievement of a steady economic growth, huge employment opportunities, world class infrastructural facilities and improved living condition (Hatta & Ali, 2013; Nair, 2010).

2.1.2.1 Ethnic Profile of Poverty

Despite an impressive decrease in the incidence of overall poverty from 49.3% in 1970 to 1.7% in 2012, the ethnic dimensions of poverty were still significant. The Bumiputera had a poverty incidence of 8.3% in 2004 compared to 0.6% and 2.9% for the Chinese and Indians respectively. Yet still in 2012 the Bumiputera had the highest incidence of poverty at 2.2% while Chinese and Indians had 0.3% and 1.8% respectively. The data continued to depict the same trend with the Bumiputera having the highest incidence of poverty.

According to Henderson et al. (2002), the persistence of poverty amongst Bumiputera households has been attributed to the fact that the bulk of them live in rural areas, dependent on agriculture and lacks productive assets. These issues are connected with low income/earning and that perpetuates poverty. The various strategies adopted by government in subsequent policies and plans were informed by these underlined problems.
2.1.2.2 Poverty and Income Distribution

Another dimension of poverty in Malaysia is the disparity in rural-urban poverty. The incidence of poverty in rural households was 58.7% in 1970 and 3.4% in 2012 compared to the urban 21.9% and 1% for the respective years. Although the incidence of poverty has been on the dwindling trend, it has widen the disparity between the two groups. This means that the rapid economic growth has more positive impact in urban than in rural regions. According to Roemer & Gugerty (1997); Kanbur & Venables (2003), some macro-level economic policies have been associated with increase in spatial inequalities and higher incidence of rural poverty despite overall economic growth. While the export-oriented agriculture has been linked to the decreased food security for rural populations, much emphasis for urban growth is often at the expense of rural areas. As mentioned earlier in section 2.1.1, localization of industries in one area facilitates the development of infrastructure, mobility and communication. Without a careful prioritization of these amenities, it makes poverty to concentrate in other areas for its inability to compete economically. This may hinder the isolated areas to integrate with urban society, access to capital and established markets, and could impede human progress and development (Gallup et al., 1998; Foster & Székely, 2001). In addition, it may trigger a rural-urban migration to take advantage of the new opportunities in terms of higher income, education and social amenities (Siwar & Kasim, 1997). This causes other urbanization challenges such as unplanned growth, pollution and higher crime rates (Dahlquist, 2014). On the other hand, it compounds the rural problems in terms of social services, infrastructure as well as the required labour for the fledging rural opportunities. To face this inequality question, it will require the development of poverty profiles that will expose a more detailed characteristics of the poor so that a target-specific approach is implemented.

2.1.3 Social inclusion

According to the World Bank Group (2013), social inclusion is a process of improving the condition of individuals and groups to enable them to take advantage of the opportunities in their society. It is essential to empower the poor people so that they have freedom and access to the opportunities in the society. There are suggestions from
the literature that, the vulnerable people are systematically blocked from various aspects of their rights, opportunities and resources (Raimi et al., 2013; Zin, 2013; Farrigan & Parker, 2012). This alienates a section of the society from participating fully in the economic, social, and political life of the society in which they live. It may be as a result of their social status, low education and health condition. As reported by Bennet (2002), the European concept of social exclusion encompasses the failure of people’s social, economic and political relationships that includes social isolation and lack of legal rights. This may result to reducing solidarity, increasing social tensions and holding back social development.

Development will only be achieved when the economic gains improve the well-being of the poor in a direct way and are socially and environmentally friendly. This is because unequal distribution of economic gains makes the isolated segments to remain in poverty (Prabhakar et al., 2015; Bradshaw, 2006). More so, structural difficulties does not allow the poor people to excel regardless of how competent they may be. Proponents of economic growth as a measure of development argue that economic growth will automatically trickle-down and spread its benefits across society, and where it fails and causes income disparities, governments will step in to remedy the situation. However, there is no universal tendency for growth to spread nor did governments always show signs of correcting gross inequalities (Fleisher et al., 2010; Stanton, 2007). The New Economic Model (NEM) in Malaysia promotes a new approach to development, which it defines as inclusive growth, to raise productivity and incomes of the poor and enable them contribute meaningfully to national development (Hatta & Ali, 2013; Xavier & Ahmad, 2012). This re-strategizing was in response to the challenges of social inclusion using direct approaches (Nair, 2010).

The NEM seeks to address issues of relative poverty and inequality and the emerging urban poverty so as to balance the rural biased strategies and rapid rates of urbanization. The new policy direction seeks to unite all Malaysians so as to face the challenge of becoming a developed nation through a vibrant private sector, knowledge-based economy, human resource development, competitive domestic economy and reengineered public sector. Although Malaysia graduated from poor to middle income nation, vulnerable groups exist for geographical and societal reasons (Hatta & Ali, 2013). To reduce income disparity across race and regions, NEM focuses on enhancing the incomes of the bottom 40 per cent of households whose average monthly household income is RM1, 500. It incorporates a new approach to development which
it defines as inclusive growth, so as to raise productivity and incomes of the poor and enable them contribute meaningfully to national development. NEM is to respond to the urgent need to arrest the declining inflows and the outflows of foreign direct investments (FDI), narrowing income disparity and develop requisite talent that are lacking across the country. According to Xavier & Ahmad (2012), NEM has three primary goals: (1) high per capita income target of USD 15,000-20,000 per year by 2020 premised on a 6.5 per cent annual growth; (2) inclusiveness (all racial communities to benefit from increased national wealth); and (3) sustainable growth that does not compromise the quality of life of future generations. This policy is essential because it recognises that all citizens are the primary ends and principal means of development.

2.1.4 Financial inclusion

The Global Financial Development Report 2014 (World Bank Group, 2013) defined financial inclusion as the proportion of individuals and firms that use financial services in a particular society or country. To improve financial opportunities to all members of society, the poor people, especially the rural residents must have access to formal financial system. Financial exclusion occurs when people do not have access to fair, safe and affordable banking products and services (Burkett & Sheehan 2009; Chant Link & Associates, 2004). Lack of access to appropriate financial services to run their lives and businesses has been identified as one of the predicaments of the poor people (Mohieldin et al., 2011). One of the main aims of microfinance programs in Malaysia is to achieve financial inclusion. The 2006 Microfinance framework was conceived for the development of a viable financial inclusion. This is a strategic move to identify the boundaries of an appropriate micro financing services. Essentially, it was to raise awareness on micro financing, and to attract the participation of financial institutions in providing micro financing solutions (Muridan & Ibrahim, 2015). Similarly, the Financial Sector Blueprint (FSBP) 2011–2020 in Malaysia was formulated to increase productivity, diversify sources of income and improve the quality of life of the poor. This is a strategic plan that charts the future direction of the financial system as Malaysia transitions towards becoming a high value-added, high-income economy. One of the agenda for this 10-year blueprint is to pursue a financial inclusion that will
enable all citizens undertake financial transactions, generate income, accumulate assets and protect themselves financially against unexpected adverse events (FSBP, 2011). This commitment to financial inclusion is embedded in the Central Bank of Malaysia Act 2009. This Act made the promotion of a sound, progressive and inclusive financial system as one of the functions of the Bank. Figure 2.2 below presents the financial inclusion position of Malaysia among some selected nations.

Figure 2.2: Malaysia Financial Inclusion (Consultative Group to Assist the Poor (CGAP) and Bank Negara Malaysia cited in FSBP, 2011)

Figure 2.2 indicates that the financial inclusion reforms in Malaysia are yielding positive results. Deposits have increased from 1,975 accounts per 1,000 adults in 2000 to 2,954 deposit accounts per 1,000 adults in 2010. Meanwhile, the take-up of financing has increased from 310 financing accounts per 1,000 adults in 2000 to 858 financing accounts per 1,000 adults in 2010. This result has placed Malaysia above major ASEAN countries on financial inclusion. It has equally elevated Malaysia’s position in various global financial inclusion rankings. According to FSBP (2011), it gained the number one ranking since 2007 for “Getting Credit” in the “Ease of Doing Business” index by the World Bank. Also, number eight out of 142 countries in 2011 for “Ease of Access to Loans” by the World Economic Forum. This may be seen as a reflection of the new drive for an inclusive growth in Malaysia.
From the foregoing discussion, causes of poverty has been outlined as well as what kept some people in poverty in the Malaysian context. The government policy and plans towards social and financial inclusion were discussed. This has made the basis for this research work because the focus of Malaysia is towards an inclusive growth, and it is in line with the approach of sustainable development goals (SDGs)

2.2 Islamic microfinance

2.2.1 Introduction

Islam is a complete way of life. It defines the political and socio-economic endeavours of Muslim faithful in accordance with the teachings of the Quran and Sunnah. Islamic finance is based on the principles of Islamic economics that stems from the Muslim world view. This view entails the purpose of human creation, social and material well-being of individuals in this world and Hereafter (Dusuki, 2006). While the conventional economics is based on human reasoning, Islamic economics is based on reason and divine guidance that encompasses spiritual, moral and social needs of human beings as vicegerents of Allah on earth. Aydin (2013) defines Islamic economics as an “economic system based on the Islamic view aiming to realize spiritual, moral, intellectual, social and material well-being of individuals in this life and the Hereafter through allocation and distribution of scarce resources in a morally guided market system”. This goes to affirm that in Muslim society, human existence as well as its socio-economic transactions is geared towards the well-being of individuals and the society at large to attain success in this world and Hereafter. The major socio-economic goal of Islam is economic prosperity characterized with justice and equitable distribution of income and wealth. Therefore the conduct of business and commerce is influenced by teachings of Islam just as other spheres of life so as to ensure justice and fairness (Brown, Hassan & Skully, 2007). Islamic finance is a system that provides a variety of financial services capable of achieving economic prosperity and equitable income distribution in line with teachings of Islam (Aydin, 2013). Islamic finance, whose foundations are embedded in the Quran and Sunnah (teachings of Prophet Muhammad, peace be upon him), aims to promote trade based on profit and loss sharing; and prohibition of riba (interest) and gharar (speculation).
REFERENCES


