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INFLUENCE OF INTELLECTUAL CAPITAL DIMENSIONS AND GOVERNMENT SUPPORT ON THE PERFORMANCE OF ISLAMIC MICROFINANCE INSTITUTIONS IN MALAYSIA

BY

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ABSTRACT

The performance of Islamic microfinance institutions involves examining its development towards accomplishing its goals. Therefore, it is essential for Islamic microfinance institutions to determine the key challenges to maintain their operations and remaining sustainable. Islamic microfinance institutions need to focus on its intellectual capital and further prioritize their relations with government bodies and perform well so as to remain sustainable in the future. The aims of this research are to investigate the influence of intellectual capital dimensions (namely human capital, structural capital, customer capital and social capital) and the government support on the performance of Islamic microfinance institutions. This study has included knowledge as a new variable which affect the human capital (mediator) and lead to better performance of Islamic microfinance institutions. In addition, this research also focused on the impact of geographical location (moderator) of Islamic microfinance institutions towards the relationship between intellectual capital dimensions and government support on the Islamic microfinance institutions performance. A cross-sectional survey design was used to gather data from 145 managers (48% response rate) from Islamic microfinance institutions in Malaysia. To determine the sample size of the study, a judgmental sampling method was employed. Partial least square-structural equation (PLS-SEM) was used to analyse the research model. Subsequently, the research model was validated using Smart PLS 3.2.6 and proposed the study hypothesis. The findings confirmed that structural capital, customer capital, and government support positively influenced the performance of Islamic microfinance institutions, except for social capital and human capital. The result also showed that the relationship between knowledge and the performance of Islamic microfinance institutions was mediated by human capital. Further, moderation analysis showed that the geographical location of Islamic microfinance institutions moderates the relationship between intellectual capital dimensions (customer capital and structural capital), and the performance of Islamic microfinance institutions. The research model explained 72.4% of the substantial amount of variance in the performance of Islamic microfinance institutions. This research theoretically contributed to the extension of knowledge-based theory and resource-based view (RBV) in predicting the Islamic microfinance institutions performance (sustainability theory). This study is a self-reported study and is limited to selected respondents, specifically IMFI managers, and this might lead to biased perceptions towards the institutions. Therefore, future research need to focus on the different set of data collection for exogenous variables (collected from primary data) and endogenous variable (collected from secondary data) to avoid the common method bias. Overall, it can be concluded that, all dimensions of intellectual capital and government support improve the performance of Islamic microfinance institutions. Lastly, mediator and moderator do contribute to the performance of IMFIs.

ملخص البحث

من أوليات تطوير أداء مؤسسات التمويل الصغرى، وضعها تحت الدراسة لتفعيل أداءها، وتحقيق أهدافها، ولأجل الحفاظ على عمليات المؤسسات الصغرى، واستمراريتها، من الضروري تحديد التحديات والاوليات الرئيسية، تفتقر مؤسسات التمويل الصغرى للتركيز على رأس مالها الفكري، وتطوير علاقتها بالهيئات الحكومية ،لضمان تميز أداءها، واستدامته، يهدف البحث لدراسة تأثير البعد ال رأسمالي الفكري (رأس المال البشري، ورأس المال الهيكلي (البنية التحتية)، ورأس المال الاجتماعي) كذلك الدعم الحكومي ،ومدى تأثيره في أداء المؤسسات ذات التمويل الأصغر .تضمنت هذه الدراسة عنصر المعرفة باعتباره عنصر بشري (وسيط) يؤثر على أداء التمويل الإسلامي الأصغر، كما كشفت الدراسة عن أهمية الموقع الجغرافي (ك وسيط ومشرف) ومدى تأثيره وابعاده في أداء تمويل المؤسسات المالية الصغرى. ولجمع معلومات الدراسة تم استخدام تصميم بيانات مشترك، وتم جمع البيانات من 145 مديرا، (وكان معدل الاستجابة 48% من مؤسسات التمويل الصغرى في ماليزيا ،ولتحديد فاعلية الدراسة تم استخدام المعادلة الاندماجية (PLS-SEM) المربعات الصغرى الجزئية لنماذج المسار لهيكلة المربعات الصغرى الجزئية. وقد تم التحقق من صحة نموذج البحث باستخدام PLS.3.2.6 الذكية ومقترحات فرضيات البحث، وأكدت الدراسة مدى تأثير البنية التحتية، وراس مال العملاء، والدعم الحكومي بصورة إيجابية في تطوير وتفعيل أداء المؤسسات الصغرى باستثناء رأس المال الاجتماعي ورأس المال البشري. وأظهرت لدراسة العلاقة المطردة بين المعرفة وأداء مؤسسات التمويل الإسلامية الصغرى، وأهمية رأس المال البشري، كعنصر مؤثر في تطوير العمل وتحديثه .واظهرت النتائج مدى أهمية الموقع الجغرافي في التأثير على الأداء والعلاقة بين رأس المال العميل والبنية التحتية للمؤسسة المالية، شرح نموذج البحث 72.4% من التباين الكبير في أداء مؤسسات التمويل الإسلامية الصغرى، كما ساهم البحث نظريا في توسيع النظرية المستندة على المعرفة والنظرية القائمة على الموارد (RBV) نظرية التنبوء بأداء مؤسسات التمويل الإسلامية الصغرى (نظرية الاستدامة)، ومن المهم الإشارة إلى أن هذه الدراسة اقتصرت على مجموعة مختارة من المدراء المستجيبين، وتحديد المدراء (IMFI) مع اعتبار عامل التحيز تجاه المؤسسة، لذلك توصي الدراسة بتناول الموضوع بشكل مختلف، والاعتماد على جمع البيانات بصورة مغايرة لتجنب التحيز، والاعتماد على المتغير الداخلي والخارجي، وملاحظة التبيان بين البيانات الداخلية والخارجية، ومن حيث العموم يستنتج البحث تأثير رأس المال الفكري والدعم الحكومي في تحسين وتطوير أداء المؤسسات المالية وفي الغالب يعتبر الوسيط عنصر مهم في تغذية المؤسسات المالية الإسلامية الصغرى وتطويرها .

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DECLARATION

I hereby declare that this thesis is the result of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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This thesis is dedicated to my beloved parents

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Firstly, it is my utmost pleasure to dedicate this work to my mother Jannath Beeve, my beloved husband Nizar bin Misbah and my kids Nur Syakirin, Nur Nabila, Nur Farzana and Muhamad Hakim Danial, who granted me the gift of their unwavering belief in my ability to accomplish this goal: thank you for your support and patience.

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LIST OF ABBREVIATIONS

AVE	Average Variance Explained
CB-SEM	Covariance Based – Structural Equation Model
CC	Customer Capital
DV	Dependent Variable
GS	Government Support
HC	Human Capital
HTMT	Heterotrait-Monotrait Ratio
IC	Intellectual Capital
IMFIs	Islamic Microfinance Institutions Performance
IVs	Independent Variables
LVs	Latent Variables
MFIs	Microfinance Institutions
PLS-SEM	Partial Least Square – Structural Equation Model
SC	Structural Capital
SD	Standard Deviation
SEM	Structural Equation Model
SO	Social Capital
VIF	Variance Inflation Factor

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Islamic Microfinance Institutions (IMFIs) performance is crucial to ensure that the funds deposited by donors into the microfinance program is utilized efficiently and to assist regulators in monitoring the institutions (Kheder, Mustafa, & Saat, 2013). In this regard, ineffective IMFIs will restrict the development of the microfinance industry. Assessing the performance of IMFIs involves examining their development toward accomplishing the institution's goals and consequently, performance measurements are used to manage and sustain IMFIs.

Microfinance was first proposed as a way to eradicate poverty by providing low-income earners with a credit facility to fund small businesses to allow the borrowers to work toward becoming economically self-sufficient (Tuyon & Alfonso, 2012). As the low-income group or also known as the unbanked, essentially have no access to formal financial services (Qayyum & Ahmad, 2006), the advent of microfinance provides the opportunity for them to borrow funds without the need of collateral, proof of a stable income, or a guarantor and at time, the proof of income is not even necessary. Borrowers will only gain the returns, which are subjected to the funds being used to start a business enterprise. The financial support offered by MFIs will lead to the development of the country's economy as it will improve the standard of the living for the poor, ensuring a fair distribution of income, establishing new firms, and enhancing the well-being of the poor (Al-Shami, Majid, Hamid, & Rashid, 2014).

In Malaysia, the only microfinance offered by financial institution is micro loans, and so the terms ‘microcredit’ and ‘microfinance’ are used interchangeably. Here, microfinance is also provided by non-bank institutions which provide micro loans to private financing and micro enterprises. However, bank-based IMFIs only lend to selected micro enterprises (Tuyon & Alfonso, 2012). Furthermore, Mokhtar (2011) noted that the only microfinance services offered in Malaysia is microcredit loans due to the restriction imposed by the Banking and Financial Institution Act (BAFIA; 1998) or now known as the Financial Services Act (FSA; 2013) (BNM, 2014). Majlis Amanah Raya (MARA) was the first Malaysian government agency to offer micro loans in 1966, followed by Amanah Ikhtiar Malaysia (AIM) in 1987, which provided loans solely to the poor which support them in setting up micro enterprises. This was followed by Yayasan Usaha Maju (YUM) and The Economic Fund for National Entrepreneurs Group (TEKUN) in 1988 and 1998, respectively. These institutions are non-banking institutions. Eventually, after collaborating with Bank Negara Malaysia (BNM), the government of Malaysia realized that micro enterprises are very important for the growth of the country’s economy. Therefore, in early 2006, the government urged financial institutions specifically development and commercial banks to promote microfinance products to the public. To develop the Islamic Microfinance Institutions (IMFIs) industry in Malaysia, Tuyon et al. (2011) suggested enhancing two aspects: (1) the framework of the IMFIs, including their sustainability, outreach, funding, staff competency, product development and entrepreneurship development programs; and (2) the regulatory structure and supervision of the industry, which involves close monitoring by BNM and the development of a one-stop microfinance center.

In the meantime, the problem of global poverty could not be resolved in one go. Relying on microfinance alone cannot solve the problem as solely improving health, education, or economic growth will not solve the problem. In this regard, even though microfinance can end poverty and reduce the hardship for others, it is not a miracle cure. Nevertheless, when implemented effectively, combining microfinance with a broad array of empowering interventions could, create a powerful tool that is capable of targeting the impoverished, and it could release the potential of poor people. Microfinance is thus an indispensable tool in our quest for a world free from poverty (Yunus, 2009).

It is extremely important for IMFIs to determine the key challenges in maintaining their operations and remaining sustainable (Kahaso, 2012). As the knowledge-based economy has led to a complete transformation of current businesses, it is essential to determine the wealth and sustainability of an IMFIs. The growth of knowledge-based economy is derived from intellectual capital (IC) and will enhance competitiveness among organizations, regardless of whether they are profit or non-profit oriented (Adnan et al., 2014). IC covers strategies, models, methodologies and unique approaches used by organizations to generate, value, compete, solve problems, and emulate resources (Akpinar & Akdemir, 1999). According to Kamukama et al. (2010), establishing intangible assets (the IC) against the usage of total assets would lead to better results. Furthermore, in this modern environment, it is believed that IC is the driver of firm values instead of physical and financial capital (Kamukama, 2013a). Thus, ignoring IC would lead IMFIs to experience dilemmas such as employee ineffectiveness, low service quality, lack of knowledge, and a poor relationship with customers. Meanwhile, IMFIs nowadays face many challenges including the high tendency of employees to resign, stand down, and retire or leave the company by

other means. Hence, if IMFIs are unsustainable in the long run, their most valuable employees will likely leave the company. However, as employees have extensive knowledge about their jobs and they know what works best for the company, their knowledge, which might never have been shared or passed down to other employees, will leave the company with them (Akpinar & Akdemir, 1999). It is therefore advisable for IMFIs to prioritize IC to ensure they progress and remain sustainable long term.

The implementation of IC is new not only in Malaysia but also in the global business environment. According to Ulum (2007), in general, business circles have yet to find the right answers concerning the enhanced value that is earned by the companies. It has been conclusively shown that sustainable competitive advantage depends not only on physical assets and financial capital, but also the unique intellectual assets (Suebert et al., 2001). Furthermore, compared to tangible resources, IC resources are expected to encourage competitive advantage, which will lead to higher performance (Hitt et al., 2001). In addition, in the knowledge era, where IC represents a large part of the value of a product, the traditional annual financial statements report only presents a partial value of the intangible assets (concessions, licenses, patents, trademarks, etc.). Thus, IC, according to previous researches, is a crucial resource for the improved performance of an organization (Bontis, 1998; Bontis et al., 2000; Stewart, 1997). Intelligence activities are important for organizations so that they will be efficient in the market and will be able to obtain a sustainable competitive advantage (Luminita, Maria, Artene, Sarca, & Draghici, 2016).

Kamaluddin and Rahman (2013) posited that the competitive success and firmness of a firm depends on its IC, where it is proven that IC significantly related to

the performance of a firm. Additionally, the achievement of a company greatly rests on the contribution of the IC instead of the physical and financial resources. Similarly, support from the government is considered equally important in determining the performance of IMFIs (Rahman & Dean, 2013). Furthermore, government's support could encourage the effectiveness of microfinance distribution and increased the number of branch networks.

A study conducted in Egypt found that weak internal procedures towards performance, protocols, and the number of employees are caused by poor network, and the lack of a branch network could make operation more costly and time-consuming (Brandsma & Hart, 2002). The authors added that the development, enlargement and alliance of the IMFIs are the key challenges for the shortage of trained employees (Brandsma & Hart, 2002). Furthermore, Rahman and Dean (2013) showed that limited branch networks, the lack of internal procedures concerning performance, protocols, and competence of supervisors and employees are some of the barriers affecting the performance of IMFIs. It is therefore important for the IMFIs to develop resource centres and training material to enhance their services. Another important challenge faced by the IMFIs is managing their IC. Consequently, the higher-level management is doubtful whether the respected resources that are administered by the firm will eventually lead to the achievement of new strategies. This is because they neither understand the nature and value of their IC nor know how to create, extract, and optimize value and wealth through their IC (Kamaluddin & Rahman, 2013). Consequently, IMFI managers who wish to expand their institutions should have the capability to enhance the company's intelligence, support innovation, and integrity, which are the main skills of IC (Akpinar & Akdemir, 1999).