

Social Performance of Islamic Microfinance Institutions: Examining the Financial Sustainability as Driving Factor

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ABSTRACT

This study examines the impact of financial sustainability on the achievement of IMFIs (Islamic Microfinance Institutions)' social performance. It is a quantitative study supported by a survey on six units of Islamic Rural Banks in the province of West Sumatera, Indonesia, from 2012 to 2018. This study used secondary data collected from the publication of financial services authority and other financial documents of Islamic Rural Banks. The data were analyzed by implementing the Panel Data Regression. The results indicate that financial sustainability, proxied by Return on Assets (ROA) and Return on Equity (ROE), affects social performance achievement. These findings elaborate on the previous studies that identify a relationship between these two aspects in microfinance institutions. The existence of a new predictor in the model, NOM (Net Operating Margin), has proven to give insignificant impact on the achievement of IMFIs' social performance. This study concludes that financial sustainability is the driving factor in determining the achievement of IMFIs' social functions. Thus, strengthening financial sustainability will greatly impact the achievement of IMFIs' social function in their role as community banking.

KEYWORDS

Social performance
Financial sustainability
Islamic microfinance

INTRODUCTION

The concept of social performance can be seen as an effective interpretation of social mission turning into real practice in the economy (Hashemi, 2007) and how far the financial institutions can serve low-income communities (Mersland & Strøm, 2014; Puteri, 2020). The social performance of Islamic microfinance institutions (IMFIs) is reflected in how far their role in accelerating economic development, or how far they have reached their aims to present social benefits for the poor or communities unreached by formal financial institutions. In the microfinance literature, this concept is reflected in the terms of outreach that refers to the efforts of Microfinance Institution (MFIs) to distribute financings or other financial services to the communities, especially to the poor people. Two popular indicators for this concept are the depth of outreach and the breadth of outreach (Kaur, 2014).

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The discussion about social performance becomes more interesting for Islamic Microfinance Institutions (IMFIs) because this concept is closely related to social functions in Islam. Like Islamic banks, IMFIs apply social missions as a philosophical foundation of their operations. Their purposes should be in line with the objectives of Islamic economics; the application of *Maqasid al-Shariah* in its holistic way. Furthermore, the concept of social responsibility in Islamic banks is based on five Islamic principles which include *Tawhid*, *Sharia*, Justice, Benevolence, and also *Maslahah*. These principles distinguish the practices of Islamic banks' social function from those conducted in conventional banks (Basah & Yusuf, 2013). Thus, these two kinds of banks can be differentiated from three major aspects which include foundation, management, and products (Grassa & Matoussi, 2014).

Although social function seems to be integrated with Islamic financial institutions, not all IMFIs can carry out this function. Some previous studies claim that achieving both the targets of IMFIs, social performance and financial performance at the same time, is a "mission impossible". The main problem that often occurs at rural banks is the difficulty in achieving these two targets simultaneously and ultimately causes the inequality between financial performance and social performance (Abdulai & Tewari, 2017; Caserta et al., 2018; Churchill, 2020; Huq et al., 2017). Nevertheless, other studies have actually shown optimistic findings where these two targets could be attained simultaneously (Arsyad, 2008; Bassem, 2012; Caserta et al., 2018; Gakhar & Meetu, 2013; Lebovics et al., 2016; Qinlan & Izumida, 2013; Zerai & Rani, 2012). Some researchers still believe that they can be achieved together if the effects of trade-offs can be minimized and there is synergy in the operational management of Islamic microfinance institutions (Bédécarrats et al., 2012).

Cost efficiency remains a major consideration for MFIs in channeling financing to poor people or un-bankable segments. The success of MFIs in alleviating poverty depends on the conditions of its financial sustainability, especially for Islamic Rural Banks that are categorized as MFI under the institutionalist view. Previous research agrees that the social performance of MFIs must be in line with their financial performance (Amelec & Carmen, 2015; Churchill, 2020; Gashayie & Singh, 2014; Kipsha & Zhang, 2013; Puteri, 2020). If the financial performance target is good, the institutions will sustain so that they can serve the low-income community that has higher credit risk. With this explanation, only IMFIs that have financial sustainability are assumed to be able to carry out their social functions.

Further investigation shows that financial sustainability is identified as a factor influencing the achievement of social performance at MFIs. Previous studies support this assumption because some commercialization factors have been identified to cause differences in the achievements of MFIs' social performance (Bédécarrats et al., 2012; Gashayie, 2015; Kaur, 2014; Qinlan & Izumida, 2013; Quayes, 2012; Sheremenko et al., 2017; Zerai & Rani, 2012). Although not precisely the same as the concept of financial sustainability, the commercialization factor is the closest proposition to social performance. The finding of Kipsha & Zhang (2013) is interesting for further elaboration. This study finds a positive association between financial sustainability and outreach in MFIs under the institutionalist approach and shows no trade-offs between financial performance and the outreach to the poor. However, these findings are not always the same for every MFI condition since it depends on the constructs used and also with estimation model specifications. The study recommends that microfinance institutions should be focus on financial sustainability to minimize institutional dependence on subsidy in order to ensure survival and growth in the future. It also provides a space for the use of different proxies in measuring financial sustainability and adjusting it to the types of MFIs examined in future studies.

Considering the above explanation, this current study aims to measure the contribution of financial sustainability as a driving factor in the achievement of Islamic microfinance institutions' social performance. It tries to elaborate on the previous findings (Gashayie, 2015; Kipsha & Zhang,

2013) about the relationship between financial sustainability and IMFIs' social performance by applying different proxies to measure financial sustainability and examining the issue in Islamic Microfinance Institutions. The application of different proxies aims to adjust to the distinction of IMFIs and the development of their financial regulations, which of course cannot be compared to Islamic banks. This study is worth analyzing because of the limitation of previous studies on observing the impact of financial sustainability on social performance, especially in IMFIs. Taking the case at Islamic Rural Bank as microfinance under the institutionalist approach, unsubsidized by government, and operating with Islamic principles would give a new perspective. IMFIs are well known for their social mission as the effort to apply *Maqasid al-Shariah* holistically. This research will reveal the reason why the social function runs well at some IMFIs but fails at others, with financial sustainability as the driving factor.

LITERATURE REVIEW

Social Performance

The concept of social performance in MFIs generally refers to a condition of how far the financial institutions can serve the low-income community which is unreached by formal financial institutions (Mersland & Strøm, 2014; Thrikawala et al., 2013). This achievement of social performance will be reflected by how far the role of microfinance institutions towards economic expansion. In other words, to which extend the MFIs have achieved their targets to give social benefits to poor people, which is measured by outreach (Puteri, 2020). Social performance does not equate to social impact such as the change in welfare among clients. This concept more refers to the final assessment of the ability of microfinance institutions to run their social mission, which is to overcome poverty.

Social performance covers something more comprehensive and can be measured by either the outreach or the impact assessment of a program towards a community. Although these two indicators can be used, outreach is more popular to represent how far the impact of MFIs on economic development, or how far they have reached their objective in offering social benefits for the poor community (Bibi et al., 2018; Woller, 2006). The main objective of microfinance institution is to overcome poverty through financing or providing other financial services which grant the poor and other productive sectors go together sustainably. Outreach can function as the best proxy of how far MFI has attained its purpose of giving social benefits for poor people, and this proxy is certainly also suitable for IMFIs.

Outreach can be seen as attempts to expand microfinance services to those who are underserved by formal financial foundations. Its two common aspects are the depth of outreach and the breadth of outreach (Churchill, 2020; Kaur, 2014; Rhyne, 1998). Both of them refer to the poverty degree of the clients served and the number of people served by the MFIs. The breadth of outreach is scaled by using the number of clients served while the depth is by using the socio-economic level of clients (Kaur, 2014; Lafourcade et al., 2005; Rao & Fitamo, 2014).

Financial Sustainability

Financial sustainability shows the ability of financial institutions to rely on their self-operations to cover operational costs. In microfinance institutions, this concept refers to the capability of the institution in covering all its costs from its operating income without depending on external funds such as subsidies. Conceptually, MFIs have to ensure the availability of their Financial Resources in

the long run and allocate them to cover all costs. Financial sustainability points to the degree that an institution is adequate for generating income from offered services to fulfill all the operational costs. Thus, the Financial Sustainability in MFIs declares that income from the microfinance services should be greater than the cost of providing the service itself (Gashayie & Singh, 2014; Kipsha & Zhang, 2013; Piot-lepetit & Nzongang, 2014; Schreiner, 2003). This condition is very important because MFIs will not be able to serve the poor without a stable financial condition. Besides, they will gradually perish without financial abilities.

The concept of financial sustainability has two degrees which include OSS (Operational Self-sufficiency) and FSS (Financial Self-sufficiency) (Forster et al., 2003; Torre & Vento, 2006). Both of these measurements must be applied by MFIs, and they are relevant for those under Institutional Views such as Islamic rural banks. OSS (Operational self-sustainability) is attained when MFIs can earn enough income to cover all costs but still depend fully or partially on subsidized assets. Meanwhile, FSS (Financial self-sustainability) is gained when an MFI earns positive net income independently from a donor institution and can even give positive returns to its investors. The purpose of the FSS is to appraise whether a financial institution earns enough revenues from lending to cover all operational costs, financing costs, provision for financing losses, and the cost of assets. An MFI is financially self-sufficient when the institution can cover all costs from its own generated income.

Some other literature reveals that sustainability or profitability is also measured by Return on Assets (ROA) and Return on Equity (ROE) (Cull et al., 2007; Olivares-Polanco, 2005; Zeraï & Rani, 2012). ROA reflects how well an MFI uses the institution's total assets to create returns while ROE is a ratio that measures the total amount of return earned on equity deposited. Although ROA and ROE can represent the profitability or even financial sustainability of a bank for the long run, both are still used together due to several considerations. ROE is more appropriate in describing the capital structure of a bank because it shows the composition of net income derived from owned capital (equity). Whereas ROA only describes the ability of banks to generate profits from assets, which is the accumulation of liabilities and equity. If ROA is good, it is also necessary to check the ROE, and if ROE is also good, it means that the rate of return is better. Thus, both of these proxies are the reflection of the financial sustainability of MFIs.

Because IMFIs are unique in terms of products and services that characterize the Islamic financial model, Net Operating Margin (NOM) is considered a quite relevant proxy to measure financial sustainability in Islamic financial institutions. NOM is a ratio to assess the ability of a bank's management to carry out its productive assets in order to produce revenue-sharing that contributes to increasing the profitability and financial sustainability of the bank. NOM is a bank profitability ratio, which is one indicator of measuring the level of efficiency of Islamic banks. Through the measurement of efficiency, Islamic banks can set strategies on how to get maximum output with minimum input levels. This is a performance parameter that measures all the performances of Islamic banks, including social performance. The concept of NOM is analogous to NIM (Net Interest Margin) used by conventional banks, a ratio that is very closely related to the ability of banks to manage productive assets so that they can generate net interest. The previous findings show many statistically significant relationships between the measurement of bank efficiency as represented by NIM (net interest margin) and bank profitability (Hasan et al., 2020; Imtiaz et al., 2019; Wijayaa & Yudawisastrab, 2019).

Hypotheses Development

Islamic Rural Bank is one type of MFIs with the institutionalist approach that emphasizes the importance of independent financial performance which is not subsidized by the government; thus,

the efficiency of funds is important for future self-sufficiency (Gan & Nartea, 2017). Moreover, Islamic rural banks operate like a bank that is responsible for the general meeting of shareholders for reporting earnings, so that financial sustainability becomes something that is very important in its operations.

Previous studies have placed the importance of social performance for MFIs, whether operating within an Islamic framework or not. In line with the purpose of their establishment, MFIs are the pillar of development and play an important role in poverty alleviation, especially in rural areas (Begum et al., 2019; Fianto et al., 2019). It is analogous with *Sadaqah* and *Infah* that can only be done if someone has a good financial ability. Although the effect of financial sustainability on social performance has not been directly tested, previous studies provide a quite relevant proposition to this research. The commercialization factors have been identified as the cause of the difference in the achievement of MFIs' social performance and it has been proven that there are complementary conditions between financial sustainability and the outreach of microfinance (Churchill, 2020; Kaur, 2014; Qinlan & Izumida, 2013). Those studies have also found the significant positive impact of financial performance on social performance by using ROA as a proxy for MFIs' profitability and concluded that profitability negatively affects the outreach to the poor, indicating the presence of trade-off (Hermes & Lensink, 2011; Piot-lepetit & Nzongang, 2014). Then, to make a bridge between social goals and financial goals, improving the allocation of capital is compulsory (Axmann, 2015).

Generally, a literature review of (Gashayie, 2015) has described the importance of financial sustainability in MFIs and has shown the factors that affect it, including MFI's related factors, borrower related factors, and macroeconomic related variables although initially it was suspected that the relationship between financial sustainability and outreach will be more dominant in the MFIs with an institutional approach. Meanwhile, Quayes (2012) shows empirical evidence of a positive complementary relationship between financial sustainability and outreach for subsidizing microfinance institutions or for MFIs with the welfarist approach. The causal relationship between financial sustainability is also analyzed in reverse paradigms research and the results show that outreach significantly affects financial sustainability (Churchill, 2020; Churchill & Marr, 2017). Even in several cases in formal MFIs in Indonesia, such as rural banks, it is also revealed that there is a trade-off between financial functions and social functions (Puteri, 2017, 2020).

One closest study we found of the causal relationship between financial sustainability and social performance in MFIs with the institutionalist approach is the one by Kipesha & Zhang (2013). The results show the positive influence of financial sustainability on outreach as quantified by several proxies such as the cost, depth, breadth, and scope of outreach. These findings reveal that MFIs can concentrate on financial sustainability to grant them to cover the operating costs and ensure their going concern with fewer dependencies on subsidies without compromising outreach to the poor people. However, this study has a limitation. The presence of trade-offs between financial performance and social performance for the poor segment greatly depends on variables applied and also with its estimation model specifications.

Other previous studies on the relationship between these two have used several popular proxies to measure financial sustainability, such as ROA and ROE (Churchill, 2020; Churchill & Marr, 2017; Cull et al., 2007; Henock, 2019; Meyer, 2019; Olivares-Polanco, 2005; Zerai & Rani, 2012). These two proxies are considered to reflect the financial sustainability condition in microfinance institutions. However, the existing distinctions in Islamic financial institutions make it needs to expand other measurement instruments to capture their characteristics. In observing conventional financial institutions, several studies place NIM (Net Interest Margin) as a proxy for bank efficiency; meanwhile, there is a NOM (Net Operating Margin) for Islamic financial institutions, which means a ratio of the ability of banks to manage productive assets so that they can produce net interest.

Previous findings indicate that there are many statistically significant relationships between the measurement of bank efficiency represented by NIM and bank profitability (Hasan et al., 2020; Imtiaz et al., 2019; Wijayaa & Yudawisastrab, 2019). This new proxy placement is expected to be relevant and needs further testing.

Based on the previous studies and also as an effort to expand relevant studies on IMFIs, this current research tries to test the following hypotheses:

H₁: ROA can increase the achievement of social performance

H₂: ROE can increase the achievement of social performance

H₃: NOM can increase the achievement of social performance

RESEARCH METHOD

Research Design

This study was explanatory research that discussed the causal relationships between variables and tested hypotheses that had been formulated. It was field research with a quantitative approach conducted at six units of Islamic Rural Banks in the province of West Sumatra, Indonesia, from 2012 to 2018. The panel data regression was implemented to test whether the dimensions of financial sustainability were able to improve the achievement of the Social Performance of IMFIs. Some proxies used to measure financial sustainability were adjusted to the operational model of MFIs based on Islamic principles, covering Return On Assets (ROA), Return On Equity (ROE), and Net Operating Margin (NOM).

Population and Sample

The population of this research was six units of Islamic Rural Banks in West Sumatera Province, Indonesia, from 2012 to 2018, namely Gajah Tongga Koto Piliang, Ampek Angkek Canduang, Haji Miskin, Mentari Pasaman Saiyo, Al Makmur, and Barakah Nawaitul Ikhlas. Geographically, these financial institutions were spread over several regencies and cities including the District of Agam, the District of Lima Puluh Kota, the District of Tanah Datar, the District of Pasaman Barat, Sawahlunto City, and Solok City. They were purposively selected as the representatives of IMFIs. It was based on the consideration that these microfinance institutions were well organized and had a complete financial report. The data used in this research were the secondary data obtained from the audited financial report published by the Financial Services Authority and other financial reports of those Islamic rural banks.

Selecting West Sumatera as the sampling area was based on the judgment that the phenomena observed in this region support the research problems. The existence of Islamic Rural Banks which was initially expected to be able to boost the micro sector is constrained by financial problems that are getting worse and worse. Although this area is dominated by Muslim communities with a strong cultural and religious mix, up to 2019 there were only 7 Islamic rural banks in large geographical areas. As a business entity, Islamic rural banks are faced with difficulties to synergize between financial sustainability, breadth of outreach, and the impact of the existence of the rural Islamic banks themselves.

Variables and Measurement

The dependent variable for this research is the social performance proxied by the Number of Clients (NOC), which refers to the total client served by IMFIs. This measurement can represent the breadth of the outreach of IMFIs. NOC was selected as a proxy with the consideration that the instrument is best for social performance, especially for MFIs with an institutionalist approach (Gwasi & Ngambi, 2014). Meanwhile, the concept of financial sustainability is represented by three independent variables, namely ROA (Return on Assets), ROE (Return on Equity), and NOM (Net Operating Margin). These three variables are the reflection of the financial sustainability of IMFIs (Cull et al., 2007; Olivares-Polanco, 2005; Zeraï & Rani, 2012). Theoretically, they can reflect financial sustainability conditions which are defined as the ability to preserve the financial resources in the long run and to allocate them at the appropriate time and form, to cover all direct and indirect costs, and to make sure that resources are executed effectively and efficiently.

Return on Asset (ROA) and Return on Equity (ROE) were applied as proxies for financial sustainability while Net Operating Margin (NOM) was added to complement the indicators in describing financial sustainability in IMFIs. Net Operating Margin (NOM) is expected to represent financial sustainability in Islamic financial institutions because this ratio is used to quantify the potential of bank management in managing their productive assets to produce revenue-sharing. ROA aims to measure the ability of banks to generate profits through an investment of funds in all productive assets, which can be formulated as a ratio of earnings before tax divided by the total assets. ROE can be defined as the ratio used to measure the ability of banks to obtain a net profit from their capital, which is formulated by the Profit After Tax divided by their own capital. Although ROA and ROE can represent the profitability of a bank, both are still used as proxies for financial sustainability due to several considerations. ROE is better able to describe whether net income comes from the banks' own capital or not because it is more focused on measuring profits derived from equity. On the other hand, ROA only describes the company's ability to generate profits from assets which is a composition of liabilities and equity. If ROA is good then ROE needs to be observed, and if ROE is also good it means that the rate of return is also better.

Net Operating Margin (NOM) is another ratio used to complete financial sustainability measurement. NOM measures the ability of bank management to manage productive assets to yield revenue-sharing. It can be formulated as $NOM = [(OI - RSF) - OC] / PA$, with NOM as Net Operating Margin, OI as Operating Income, RSF as Revenue-Sharing Fund, OC as Operating Cost, PA as Average Productive Assets, and $(OI - PSF) - OC$ as Revenue Sharing. Revenue-sharing is derived from Operating Income minus Revenue-Sharing Fund minus Operating Costs. The higher the NOM, the higher the revenue-sharing on productive assets managed by the bank, so that the financial performance will increase.

Data Analysis Method

As mentioned before, this study estimates the impact of financial sustainability proxied by Return on Assets (ROA), Return On Equity (ROE), and Net Operating Margin (NOM) on the social performance of IMFIs. The panel regression method was used in analyzing the empirical model. The functional equation estimated is as follows:

$$NOC_{it} = \beta_0 + \beta_1 ROA_{it} + \beta_2 ROE_{it} + \beta_3 NOM_{it} + \varepsilon_{it}$$

Note: NOC is the number of Clients (a proxy for social performance), ROA is Return on Assets, ROE is Return on Equity, and NOM is Net Operating Margin.

To predict the model, the panel data regression method considered three models, namely Pooled Least Squared (PLS), Fixed Effect Model (FEM), and Random Effect Model (REM), and then were estimated by using STATA statistical software. The model selection was chosen based on the Chow test to choose between pooled least squared (PLS) and fixed-effect models, and Breusch Pagan Lagrange Multiplier (LM) test to choose a pooled least squared (PLS) or random-effect model. Last, the Hausman test was conducted between the fixed effect model or the random effect model.

RESULTS

Descriptive Analysis

The results of the descriptive analysis and the characteristics of the data for each variable in this study are presented in the following Table 1

Table 1. Descriptive Statistics of Variables

Variables	Mean	Standard Deviation	Min	Max
NOC (Number of Clients)	1182	515	345	2597
ROA (Return on Asset)	1.68	0.95740	-3.00	4.15
ROE (Return on Equity)	16.84	14.18279	-3.51	92.94
NOM (Net Operating Margin)	17.04	1.98715	12.00	22.00
N = 168, n = 6, T = 28				

Based on Table 1, it was observed that from 2012 until 2018, the Average Number of Clients of IMFIs was 1182 clients per bank with variations in the number of clients between 345 to 2597 clients per quarterly. The data also shows variations in ROA with a range of -3.00 to 4.15, and the average for ROA is 1.68. It can be interpreted that in some Islamic rural banks there was a negative growth in performance and others experiencing slow growth. These data indicate the variations in the ability of Islamic Rural Banks to generate net profits from their assets. The average ROA for Islamic rural banks is 1.68%, which implies that the Islamic rural banks can generate profits from assets with very good criteria (note: $ROA > 1.45\%$ can be categorized as "very good" based on the Central Bank of Indonesia category). Based on Table 1, it is also seen that the average ROE is 16.84%. ROE of Islamic rural banks also varies in the range of -3.51 to 92.94 with an average of 16.84. This finding implies that these Islamic rural banks have generated a profit of 16.84% of the capital owned. This rate is categorized quite well (note: $13\% > ROE < 18\%$ is in the category of "3" according to the Central Bank of Indonesia). It means that the IMFIs' ability to make profits has been in quite a good category. The next measurement of financial sustainability is NOM. The average NOM for IMFIs is 17.04 %. This finding implies that there is a very high level of Rentability, and there is a good ability from Rural Bank's management to manage the productive assets in generating the revenue-sharing.

Results of the Panel Data Regression

All test results from the causal relationships between ROA, ROE, and NOM for the social performance of IMFIs are shown in table 2. These results are the result of the panel data regression with three models of estimation methods covering PLS (Pooled least squared), FEM (Fixed effect model), and REM (Random-effect model).

Table 2. Results of Panel Data Regression

Model	Var.	Coefficient	t-statistic	p-value
Pooled least squared (PLS)	Cons	1106.541	3.41	0.001
Prob. > F = 0.000	ROA	-26.076	-0.55	0.585
R-Squared = 0.1353	ROE	14.222	4.51	0.000
	NOM	-7.091	-0.37	0.714
Fixed Effect Model (FEM)	Cons	407.766	1.60	0.112
Prob. > F = 0.0000	ROA	144.943	4.07	0.000
R-Squared = 0.2951	ROE	6.333	2.81	0.006
	NOM	24.898	1.64	0.103
Random Effect Model (REM)	Cons	431.240	1.39	0.163
Prob. > χ^2 = 0.0000	ROA	140.438	3.95	0.000
R-Squared = 0.2950	ROE	6.554	2.91	0.004
	NOM	23.7462	1.57	0.116

Testing of Multicollinearity and Heteroscedasticity

To fulfill the data quality test, the panel data regression requires the fulfillment of two classical assumptions, namely multicollinearity and heteroscedasticity. Table 3 shows the results of the Variance Inflating Factor (VIF) values for the ROA, ROE, and NOM, which are 2,368, 2,602, and, 1,156 respectively. Each of these values is smaller than the maximum tolerance limit of VIF of 10.00. Thus, it can be concluded that there is no multicollinearity in the model.

Table 3. Results of multicollinearity test

Model	Beta	t-value	Sig.	Collinearity Statistics	
				Tolerance	VIF
(Constant)		1.782	0.083		
ROA	0.300	1.226	0.228	0.422	2.368
ROE	-0.276	-1.078	0.288	0.384	2.602
NOM	-0.057	-0.333	0.741	0.865	1.156

The results of the heteroscedasticity test by assessing the regression coefficient for the residual of the social performance variables with ROA, ROE, and NOM are shown in Table 4. To interpret the results with the Glejser test, the significance value for each of the estimation coefficients in the model can be observed, namely 0.316, 0.811, and 0.958. None of these significance values are below 0.05 or it can be said as statistically significant. Thus, it can be concluded that the heteroscedasticity symptom does not exist in the estimation model.

Table 4. Results of heteroscedasticity test

Model	Standardized Coefficients Beta	t	Sig.
(Constant)		1.095	0.280
ROA	0.243	1.016	0.316
ROE	0.060	0.240	0.811
NOM	-0.009	-0.053	0.958

Selection of Panel Data Regression Model

To determine which model is the best, some tests were applied. The results of testing the model with the Chow test, LM Test, and The Hausman Test are presented in Table 5. The results of the Chow test show the Probability > F = 0.000, which means the rejection of the PLS model and the selection of the Fixed Effect Model. Breusch Pagan Lagrange Multiplier (LM) test also resumes that Probability > F = 0.000, which also means the rejection of the PLS model and decision to use the Random Effect Model. Furthermore, the Hausman test was applied for choosing between the fixed effect model and the random effect model, which then appears with Probability > F = 0.399.

Table 5. Selection of panel data regression model

Model Estimation	Probability
Chow Test	0.000
LM Test	0.000
Hausman Test	0.399

Based on the estimation model with some tests conducted, the best model used to estimate the hypothesis in this study is the Random Effect Model, as in Table 6.

Table 6. Panel regression with random effect model

Variable	Coefficient	Standard Error	z-Statistic	Prob.
ROA	140.438	35.515	3.95	0.000
ROE	6.553	2.2493	2.91	0.004
NOM	23.746	15.108	1.57	0.116
constant	431.240	309.173	1.39	0.163

Prob > Chi2 = 0.0000, R-Squared = 0.2950

Note: ROA is Return on Asset, ROE is Return on Equity, NOM is Net Operating Margin

Based on the output shown in Table 6, it appears that the panel regression with the Random Effect model is quite good and fulfills the criteria statistically (Probability > Chi2 = 0.0000, R-Squared = 0.2950). The results show a significant effect of ROA and ROE on social performance but the same does not happen with NOM. For the path of the relationship between ROA and social performance, the estimation coefficient shows that there is a positive influence of ROA on the Social performance of IMFIs (coefficient = 140.4387, p-value = 0.000). Thus, H₁. ROA is positively associated with the social performance of IMFIs, is accepted. Next, there is a significant effect of ROE on the social performance of IMFIs (coefficient = 6.553886, p-value = 0.004). Thus, H₂. ROE is positively associated with the social performance of IMFIs, is also accepted. Furthermore, for the path of the relationship between NOM and social performance, the estimated coefficient is 23.74616 (p-value = 0.116). This finding implies that financial sustainability proxied by NOM does not affect the social performance of IMFIs. This result concludes that the third hypothesis, H₃. NOM is positively associated with the social performance of IMFIs, is rejected.

DISCUSSION

The findings of this research conclude that financial sustainability affects the achievements of the social performance of IMFIs, proxied by the Number of Clients. ROA and ROE, as the proxies used to measure financial sustainability, are two important predictors that have been proven empirically

as the determinants of how far the social performance of IMFIs. The increase in ROA or ROE causes an increase also in the number of clients of IMFIs, which then affects the increase in social performance. Strengthening financial sustainability through accelerating the achievement of ROA and ROE has a positive impact on the social performance of IMFIs. However, NOM cannot be proven as a predictor of social performance. NOM, identified earlier as a complementary proxy for financial sustainability in Islamic financial institutions, does not have a significant effect on the achievement of social performance of the institutions. Higher NOM does not cause any increase in the number of clients; thus, does not increase the social performance of IMFIs as well. This finding emphasizes that the role of microfinance institutions towards economic development is strongly influenced by the financial sustainability of the institutions. Microfinance institutions can attain their dual objectives "social performance and financial performance" if these determinants can be managed precisely.

This finding has elaborated on a previous study conducted by Kipasha & Zhang (2013) that concludes a positive relationship between financial sustainability (OSS) and outreach for MFIs with the institutionalist approach. Testing the relationship between financial sustainability and social performance in other kinds of MFIs such as Islamic Rural Banks produces findings that are in line with their study despite using different variables and different estimation models. It reveals that financial sustainability, proxied by ROA and ROE, does indeed have a positive impact on social performance. The NOM, which is expected to be a new proxy that is relevant in predicting the measurement of Financial Sustainability in Islamic microfinance, turns out not to have a significant effect. Thus, IMFIs will only strengthen their social performance if only their ROA and ROE are strong enough to expand financing to poor clients.

Theoretically, these empirical findings contribute to extending the study and development of theories related to the social functions of microfinance institutions. *First*, IMFIs will only be able to conduct their social performance if only they are financially sustainable because these financial institutions are not designed for poor people and are not subsidized by the government. Several previous studies' assumption that the Islamic microfinance institution is more socially oriented than the conventional ones cannot be proven in this research. More studies are needed to analyze this view in the future with more comprehensive testing so that this normative statement can be proven. A financial institution, whatever its operational principles, is still profit-oriented. After they are financially stable in the long term, they can consider aspects of social responsibility.

Second, ROA and ROE used to measure financial sustainability are two dimensions of measurement that determine the social performance of IMFIs. The implementation of these two as popular proxies in previous studies in financial institutions (Churchill, 2020; Churchill & Marr, 2017; Cull et al., 2007; Henock, 2019; Meyer, 2019; Zerai & Rani, 2012) turns out to be quite effective and relevant in the case of Islamic microfinance institutions, even though this financial institution has a distinction in its operations. ROA is a reflection of the income derived from assets while ROE shows the ability of management to manage the capital invested by investors to generate profits. ROA and ROE are ratios used to analyze the level of banks' profitability and performance which, in the long term, can reflect the financial sustainability of the institutions. ROA and ROE are indicators of self-sufficiency in financial and have been indicated as a determinant of the social performance of IMFIs. The higher the ROA is, the more able the banks to carry out their social functions by channeling loans at a lower average rate. Theoretically, a loan with a small average is assumed to increase operating costs; thus, it will only be done by IMFIs with high profitability. ROE has also been proven to have a significant effect on improving social performance. Logically, the more the clients are, the more profit will be gained by IMFIs, assuming there is cost efficiency in financing management. This effect also applies vice versa, in which the stronger the ROE acquisition is, the more profitable banks are so they can channel more financing to more new clients, especially those in the poor segment.

Loans in this segment are usually synonymous with loans with small amounts that are assumed to increase operating costs, and this will only be done by IMFI's with high profitability. The greater the bank's profit, the greater the number of clients served. This means that IMFI's can manage their capital well in the form of productive assets to channeling financing to clients.

This study reiterates that there is a positive relationship between financial sustainability and social performance for microfinance institutions under institutionalist approaches such as IMFI's. It recommends IMFI's to concentrate on financial sustainability to ensure survival and also growth in the future as community banking. The possibility is open for IMFI's to focus on financial sustainability to guarantee their business continuity with less dependence on subsidies without compromising outreach to poor people.

Third, there is no empirical evidence proving that NOM has an impact on the achievement of IMFI's' social performance. Hope that the effect of this NOM will be analogous to the concept of NIM in conventional banks as in some previous research (Hasan et al., 2020; Imtiaz et al., 2019; Wijayaa & Yudawisastrab, 2019) still requires further testing and more advanced methodological handling, for example by using intervening variables in the relationship between NOM and social performance. NOM is not strong enough to be a predictor for social performance because it does not directly increase capital in banks, so NOM does not have a large influence on increasing IMFI's capacity for additional capital. Sometimes, the portion of the profit generated by the bank does not significantly add the capital due to the obligation of dividing the dividends to shareholders. It makes the IMFI's' capital reserves not increase which then does not enhance the capacity of capital as a resource to be channeled back into financing. Usually, capital reserves on L/R reports do not show significant positive changes because IMFI's make corrections to meet the target of profit sharing for investors.

NOM reflects net margin income from the average productive assets. The higher the NOM, the higher the funding channeled to the clients. Sometimes the placement of productive assets in the part of financing is not large enough to support banking performance and there is a suppression on the cost of obtaining bank net income. Although NOM does not significantly influence social performance, this research has tried to come up with another measurement that is considered in line with the Islamic financial principles for IMFI's. It needs further testing for proof of the relationship between NOM and social performance with more cases in IMFI's and also more strong propositions.

Finally, this study has succeeded in uncovering some findings that are expected to enrich the knowledge on social functions in microfinance institutions and contribute to the development of related theories. Some propositions that have not been identified before are increasingly clear as these findings and other empirical evidence are related to the development of this phenomenon. Fundamentally, IMFI's are indeed available with the aims of increasing the economic welfare of the Islamic community (especially in the rural areas), providing employment, and fostering the spirit of *Ukhuwah Islamiyah* (mutual assistance in Islam) through economic activities. Although the purpose of their existence is to gain the economic targets of Islam (*Maqhasid Sharia*), the effort to achieve it is not an easy matter.

Our analysis confirms what is predicted in previous studies, where social performance and financial performance are compatible. These two dual objectives of MFIs will only be achieved if synergies are combined cleverly; good financial performance is followed by good social performance. Both of these are equally important. If financial performance is regulated by the monetary authority as a condition in ranking the institutions, social performance is a reflection of the existence of Islamic financial institutions themselves that carry out social missions as a philosophical foundation in their operations. This social performance is very important because, as IMFI's' philosophy, the social function in Islamic banks is different from what is practiced in conventional banks. Social

responsibility in Islamic banks is based on five Islamic principles which include *tawhid*, *Sharia*, justice, benevolence, and *Maslahah*.

This empirical study is expected to reveal more about the implementation of social functions in Islamic financial institutions. Although the issue of social functions in MFIs has started to develop along with the development of community banking and Islamic Microfinance in the early 2000s, research that observes the issue on the IMFIs context is still very limited. The findings of this present study reveal a more comprehensive understanding than just the purpose of the existence of IMFIs alone. The implementation of the social performance concept in IMFIs is more than just about IMFIs as business entities. According to regulations, the purpose of IMFIs is for the real sector, which is as a microfinance institution committed to meeting the capital needs of the community that has limited access to commercial banks and requires financing with easier access. IMFIs are responsible for financial accessibility for poor Muslim communities and are required to have a bigger involvement in social welfare. The institution is committed to achieving the economic targets of Islam (*Maqasid al-Shariah*) which includes social justice, equitable allocation of income and wealth, and sustaining economic development. Islamic rural banks' objectives should be in line with the objectives of Islamic economics itself, which implements *Maqasid al-Shariah* in its holistic way.

CONCLUSION

It can be concluded that financial sustainability affects and acts as the driving factor in achieving the social performance of IMFIs. ROA and ROE, as the proxies used to measure financial sustainability, are two important predictors that have been proven empirically as the determinants of how far IMFIs conducts their social performance. However, the previous assumption that the greater NOM, the better the social performance is not proven in this case. NOM might improve the role of IMFIs in spreading financing for many clients but it does not guarantee to represent financial sustainability which then increases the social performance of IMFIs. Therefore, the policy to improve the social performance can be done by strengthening ROA and ROE but not so with NOM. Accelerating ROA and ROE, in the long run, can be the best solution to improve the social performance of IMFIs, and of course, make IMFIs more than just a profit-oriented financial institution but also as a community banking, especially for the poor people in rural areas. This study, then, enriches the understanding of social functions of IMFIs, as a microfinance institution that carries the importance of achieving social performance as well as financial performance.

MANAGERIAL IMPLICATION

This study has implications in strengthening IMFIs as microfinance institution that regularly operates under Law of the Republic of Indonesia number 1 in 2013 about microfinance institutions, which states that MFIs are financial institutions specifically established to provide business development and community empowerment services, through loans or financing on a micro-scale to members and the community, savings management, and providing business development consulting services that are not just for profit. Considering the dual objectives carried out by microfinance institutions, it is necessary to strengthen profitability and efficiency so that IMFIs are financially reliable to be able to carry out their social functions. Return on Assets (ROA) and Return on Equity (ROE) are two main indicators that need to be accelerated as a condition for IMFIs to be financially sustainable to empower the poor people as their market segment.

As a form of policy contribution, this study recommends to the board of directors and commissioners at IMFIs (Islamic Microfinance Institutions) to improve social performance by strengthening Return on Assets (ROA) and also Return on Equity (ROE). Strengthening financial performance is the most important requirement to achieve good social performance. Accelerating ROA and ROE in the long term can be the best solution to improve the social performance of IMFIs, and of course, make IMFIs more than just a profit-oriented financial institution but also as a community banking, especially for the poor people in rural areas in Indonesia.

Furthermore, to create a microfinance institution that prioritizes an integration of social performance and financial performance, the results of this study can serve as a judgment for policymakers. Bank Indonesia as the central bank, which is the maker of monetary policy in Indonesia, can formulate various policies to strengthen the capital structure and financial foundations in IMFIs. This policy can be directed at increasing the capacity of IMFIs so that they can function as financial institutions as well as agents of development. Subsidies, a policy that some time ago served as a solution in strengthening the capital structure for IMFIs, are still relevant to be followed up. Besides that, accelerating competition, simplifying regulations, expanding networks, strengthening digital banking capabilities, and increasing the capacity of human resources are some of the other factors that should get more attention from the government in the future.

LIMITATION AND FUTURE RESEARCH

One limitation of the research was the relatively small sample size in the study, which only includes six units of Islamic Rural Banks in West Sumatra, Indonesia. Although this study was purposively represented by the existing unit of analysis, for the need to generalize the research findings, it is necessary to analyze a larger sample in future studies. Besides that, the placement of other measurement variables for social performance and financial performance is also urgently needed in the future expansion of this study. The measurement of social performance is only proxied by Number of Clients (NOC), which only reflects the construct of the breadth of outreach. However, it can be proposed from the findings that social performance on IMFIs is highly dependent on the conditions of its financial sustainability. Apart from the above limitations, we believe this investigation has more evidence and the distinction, especially in the field of study of the social performance of IMFIs as one type of microfinance institution with the institutionalist approach

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