THE UNIVERSITY OF HULL

ACCOUNTABILITY AND GOVERNANCE PRACTICES IN ISLAMIC MICROFINANCE INSTITUTIONS : EVIDENCE FROM INDONESIA

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ABSTRACT

This thesis presents an explanatory analysis of the accountability and governance practices within Islamic microfinance institutions in Indonesia, adopting Bourdieu's theory of practice with the triad of concepts of *field*, *capital* and *habitus*. This study is based on the argument that accountability and governance are socially and subjectively constructed through internal and external mechanisms. The internal mechanism includes the organisational history and its culture, while the external factor is the context in which the organisation operates.

The concept of *field* is a guide to achieving the first research objective in examining the historical development of the Islamic microfinance sector in Indonesia. The changes and developments within the *field* are the external factors that affect the construction of accountability and governance practices within selected Islamic microfinance institutions in Indonesia (IIMFIs). The historical research method is deemed the most appropriate to provide a narrative history of the development of the *field*. This was done by interviewing and analysing the secondary data of journal research relating to Indonesia's socio-political situation over the period, the initiative on microfinance services, the Islamic resurgence movement and the financial reforms. The findings demonstrate that the development of the Islamic microfinance sector is inseparable from the socio-economic and political situation in Indonesia. Therefore, the *field* of Islamic microfinance is dynamic rather than static: it changes and develops over time.

Furthermore, the concept of *capital* and *habitus* helps to achieve the second research objective, to examine the construction and re-construction of accountability and governance within selected IMFIs in Indonesia: BMT A and BTM B. The internal factors of the growth of various types of *capital* (economic, culture, social and symbolic), imbued by the organisational *habitus*, constructed the accountability and governance *practices*. Such *practices* are developed over the period corresponding to the different stages of organisational growth. Both institutions have evolved from small pilot projects into two of the biggest IIMFIs in Indonesia by developing their own mechanisms of accountability and governance to ensure their capability to continue their operations in the future.

This study offers a unique lens for exploring, in a specific context, the construction of accountability and governance *practices*, the dynamic aspects of which traditional governance theories are unable to explain.

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ABSINDO	*Asosiasi BMT Seluruh Indonesia* (The Association of BMT Indonesia)
ADB	Asian Development Bank
AIM	*Amanah Ikhtiar Malaysia* (A microcredit program in Malaysi)
AUM	*Amal Usaha Muhammadiyah* (The economic activities of *Muhammadiyah*)
BIMAS	*Bimbingan Massal* (literally means Guidance Mass, a name of microcredit program provided by the Bank Rakyat Indonesia)
BMM	*Baitul Maal Muhammadiyah* (House of Treasure)
BMI	*Bank Muamalat Indonesia* (The first Islamic bank in Indonesia)
BMT	*Baitul Maal wat Tamwil* (The generic name of Indonesian Islamic microfinance institution)
BTM	*Baitul Tamwil Muhammadiyah* (The Indonesian Islamic microfinance institutions established by *Muhammadiyah*)
BPR	*Bank Perkreditan Rakyat* (The People's Credit Bank)
BRI	*Bank Rakyat Indonesia*
CAR	Capital Adequacy Ratio
CDF	Constituency Development Fund
CGAP	Consultative Group to Assist the Poor
DA	Discourse Analysis
DD	*Dompet Dhuafa* (A non-profit organisation, established to raise social welfare of poor people through Islamic philanthropy)
DIB	Dubai Islamic Bank

DSN	*Dewan Syariah Nasional* (Shari'ah National Council- a national committee established for the issuance fatwa/religio-legal norm regarding Islamic banking in Indonesia)
FPOs	For Profit Organisations
GTZ	German Technical Corporation
HMFP	Hodeidah Microfinance Program
ICMI	*Ikatan Cendekiawan Muslim Indonesia* (The *Organisation of Indonesian Muslim Intellectual)*
ICS	Internal Control System
IDB	Islamic Development Bank
IDR	Indonesian *Rupiah*
IFIs	Islamic Financial Institutions
IMFIs	Islamic Microfinance Institutions
IIMFs	Indonesia's Islamic Microfinance Institutions
IMS	Islamic microfinance sector
INKOPSYAH	*Induk Koperasi Syariah* (The secondary level of Islamic Saving and Loan Cooperative)
IRTI	Islamic Research and Training Institute
ITB	*Institut Teknologi Bandung* (Bandung Institute of Technology)
KUPEDES	*Kredit Umum Pedesaan* (Litearally means general rural credit, a credit program introduced by the Bank Rakyat Indonesia in1984)
LAZISMU	*Lembaga Amal, Zakat, Infaq dan Shadaqah Muhammadiyah* (The *Muhammadiyah*'s institution to adminster zakah/religious tax, infaq/fix donantion and sadaqah/donation)
MEK	*Majelis Ekonomi dan Kewirausahaan* (the Economic and Entrepreneurial Council of *Muhammadiyah*)
MFIs	Microfinance Institutions
MIX	Microfinance Information Exchange

MUI	*Majelis Ulama Indonesia* (The Council of Indonesian Religious Scholars)
MMU	*Madrasah Miftahul Ulum*
MoC-SMEs	Ministry of Cooperative and Small and Medium Enterprises
NGOs	Non Government Organisations
NPOs	Not for Profit Organtions
NU	*Nahdlatul Ulama* (The biggest mass Islamic organisation in Indonesia)
OJK	*Otoritas Jasa Keuangan* (the Indonesia Financial Services Authority)
Pakto	*Paket Oktober* (October Package, the financial regulation issued in October 1988)
PBMT	*Perhimpunan BMT* (The Association of BMT in Indonesia)
PBUH	Peace be Upon Him
PCM	*Pimpinan Cabang Muhammadiyah* (The chairman of *Muhammadiyah*'s branch office)
PDM	*Pimpinan Daerah Muhammadiyah* (The chairman of Muhammadiyah's district level)
PHBK	*Proyek Hubungan Bank dan Kelompok Swadaya Masyarakat* (the project linking bank and self-help group)
PLS	Profit and Loss Sharing
PPS	*Pondok Pesantren* 'S'
PRM	*Pimpinan Ranting Muhammadiyah* (The chairman of Muhammadiyah's sub branch office)
PINBUK	*Pusat Inkubasi Usaha Kecil* (The Centre for Small Business Incubation)
PWM	*Pimpinan Wilayah Muhammadiyah* (The chairman of Muhammadiyah's province office)
ROA	Return on Asset

ROE	Return on Equity
RM	*Ringgit* Malaysia
SEs	Social Enterprises
SOP	Standard Operating Procedure
SOM	Standard Operating Management
SMEs	Small and Medium-sized Enterprises
SSB	*Shari'ah* Supervisory Board
UAE	United Arab Emirates
UNDP	United Nations Development Program
USAID	United States Agency for International Development
VAS	Value Added Statement
YBMM	*Yayasan Baitul Maal Muhammadiyah*

PART 1

CHAPTER 1 INTRODUCTION

1.1. Background

When it first came into use, the term microfinance referred to a financial intermediation between micro-savers, micro-borrowers and micro-investors (Seibel, 2005a). This definition has evolved and, at present, microfinance institutions (MFIs) offer a wide range of small-scale financial services ranging from savings, credit, insurance and remittance in order to help the poorer consumer group who are excluded from accessing the products and services offered by the formal banking sector. MFIs gained their popularity after the conferment of the Nobel Prize in 2006 to Muhammad Yunus for his efforts in creating the economic and social development from below through microfinance (Counts, 2008).

The mechanism of microfinance is to provide small loans that create micro-entrepreneurs. The loan is provided without collateral for a short term and the repayments are usually made on a weekly basis or longer. Hence, the terms and conditions are flexible and easily understood. Poorer demographics utilise the loan for an initial capital to finance productive activities or expand their business, which makes it possible to generate income (Weiss & Montgomery, 2005), and thus become economically independent. Having some amount of money enables them to buy a decent food supply, build a well-structured house, send their children to better school, and so forth. The root of microfinance is therefore not merely about money, but about assisting people to achieve their fullest potential. Moreover, this movement also helps people to release themselves from the poverty trap, which is characterised by severe deprivation of basic needs such as food, drinking water, shelter, health, sanitation, information and access to services (United Nations, 1995). Therefore, microfinance plays a significant role in generating cash capital and building human capital, as Muhammad Yunus reflects: “money is merely a tool that unlocks human dreams and helps even the poorest and the most unfortunate people on this planet achieve dignity, respect, and meaning in their lives” (Reed, 2011:1).

Empirical evidence from many countries documents the positive impact of microfinance in increasing family income, reducing poverty, improving social wellbeing and empowering the poorest in society (Banuri, 2006; Antonio, 2008; Bayulgen, 2008; Brau, Hiatt & Woodworth, 2009; Aigbokhan & Asemota, 2011; Buera, Kaboski & Shin, 2011). For these reasons, microfinance is considered to be a potential tool for the alleviation of poverty due to the new paradigm it introduces, namely human empowerment (Greeley, 2006). MFIs have therefore been replicated across the globe and, as a result, are rapidly becoming a new industry (Hulme & Arun, 2009). Dieckmann (2008) estimated that more than 10,000 MFIs exist globally and that it is now almost impossible to find countries in which MFIs do not operate. The Microcredit Summit Campaign recorded that between 1997 and 2010, the number of MFIs reporting their involvement in microfinance increased from 618 to 3,703, and the number of MFI customers increased significantly from about 13.5 million to 195 million (see Table 1-1). The figures for the increase in MFIs joining the Microcredit Summit Campaign and the growth in the number of MFI customers during the period of 1997–2010 are presented inTable 1-1

Table 1-1 Summary of the number of MFIs and customers served between 1997–2010 (except 2008)

By 31 Dec of year	Number of MFIs (institutions)	Number of customers served (people)
1997	618	13,478,797
1998	925	20,938,899
1999	1,065	23,555,689
2000	1,567	30,681,107
2001	2,186	54,932,235
2002	2,572	67,606,080
2003	2,931	80,868,343
2004	3,164	92,270,289
2005	3,133	113,261,390
2006	3,316	133,030,913
2007	3,552	154,825,825
2008	N/A	N/A
2009	3,589	190,135,080
2010	3,652	205,314,502
2011	3,703	195,014,970
2012	3,718	203,502,307

Source: State of the Microcredit Summit Campaign 2001–2014[1]

Those figures do not include Islamic microfinance institutions (IMFIs), which have emerged in some Muslim countries. IMFIs were established to meet the demand for financial services based on Islamic Law (*shari'ah*) that strictly prohibits interest (*riba*). In general, there is no difference between the features and aims of conventional MFIs and IMFIs, except that the former is interest-based, while the latter is interest-free. While IMFIs have been developed to be as strong as their non-Islamic counterparts (Tamara, 1986), it is hard to obtain the accurate number of IMFIs across the world, since there is no specific market research data available. A global survey conducted by the Consultative Group to Assist the Poor (CGAP) demonstrates a doubling in the number of IMFIs from 126 institutions and 380,000

[1] The Microcredit Summit Campaign is an American non-profit organization established in 1997. It involves all stakeholders of microfinance : practitioners, donors, advocates, NGO, educational institutions and others to promote best practice in this field. They published annual report since 2001 in which the campaign report 2001 covered the survey from 1997-2001.

customers in 14 countries in 2007 (Karim, Tarazi & Reille, 2008) to 255 institutions and 1.28 million customers in 19 countries in 2013 (El-Zoghbi & Tarazi, 2013).

Despite the fact that the number of IMFIs is quite small compared to that of conventional MFIs, some observations found that a comprehensive range of services comprising credit, technical assistance, training and improvement of business skills significantly helps the growth of micro and small enterprises in Bangladesh, Turkey and Indonesia (Obaidullah, 2008). A series of studies examining the effectiveness of the microcredit program of *Amanah Ikhtiar Malaysia* (AIM) have been corroborated by the positive impact of IMFIs on wider society. Household incomes (in Ringgit Malaysia, 'RM') of their members increased significantly from RM142 to RM220 in 1988, from RM198 to RM457 in 1990 and from RM326 to RM932 in 2005 (Saad, 2011). Moreover, Akhuwat in Pakistan also succeeded in helping people to raise their living standards by providing various types of loans for various aspects of life: health, marriage, education and housing (Mustafa & Islailov, 2008).

Learning from this experience, IMFIs are accordingly becoming one of the strategies imperative to alleviating persistent poverty in Muslim countries. It is estimated that almost half the world's population, or more than three billion people, live below the poverty line, earning $2.5 or less per day and that approximately over half the world's poor reside in Muslim countries (Obaidullah, 2008; Shah, 2013). Moreover, four countries, namely Indonesia, Afghanistan, Bangladesh and Pakistan, account for almost half the number of poor people in Islamic countries (Elson & Formichi, 2011).

In Islamic societies, there are several charity-based institutions: *zakah* (compulsory almsgiving), *sadaqa* (voluntary donation) and *waqf* (Islamic trust) that are devoted to helping poor people (Yumna & Clarke, 2011). *Zakah* is one of the five Islamic pillars, an annual levy of individuals' wealth based on a threshold criterion that must be distributed to the destitute as well as the poor and needy.[2] While the payment of *zakah* is obligatory, *sadaqa* is voluntary. *Waqf* is perpetual charity that is created by donating assets to be used for a social purpose, such as establishing mosques, educational institutions, graveyards, and so on. Throughout the history of Islam, funds collected from *zakah*, *sadaqa* and *waqf* have been utilised to carry out the social welfare function of the government (Yumna & Clarke, 2011). However, as these funds are essentially rooted in voluntarism, the funds mobilised through charity fluctuates from time to time. As a consequence, the problem of sustainability in helping the poor in the long-term becomes a prominent issue for such organisations (Hassan, 2010). Furthermore, the approaches adopted by most charity organisations do not seem to help the beneficiaries in escaping poverty because they are not economically active in generating money. As a result, poverty persists. This suggests a need to seek alternative methods, and IMFIs are considered to be promising vehicles for eradicating poverty, especially in Muslim countries.

MFIs, including IMFIs, are distinct from other types of charities and can be classified as a social enterprise (SE) or social business. As the Nobel Peace Prize winner, Muhammad Yunus, said, "A social business is not a charity. It is a business in every sense. It has to recover its full costs while achieving its social objective. When you

[2] The Quran specifically mentioned eight groups of *zakah* beneficiaries: *masakeen* (the destitute), *fuqara* (poor and needy), *amil* (zakah collectors), *fi sabi'Lillah* (struggling for righteous cause), *gharimun* (debtors), *ibn as'sabil* (wayfarers), *riqab* (people in bondage), and *muallaf* (hearts inclined towards Islam); see The Quran, Surah Al Tawbah 9:60.

are running a business, you think differently and work differently than when you are running a charity. And this makes all the difference in defining social business and its impacts on society" (Bruinessen, 2002:50). As an SE, an IMFI must operate in accordance with business principles, aiming to recover full costs while concentrating on creating both services and social benefits. This therefore requires SE organisations to carefully manage funds in order to ensure the continuity of both their operations and their positive impact on wider society in the long term. Therefore, this study focuses on IMFIs using Indonesia as a special case study.

1.2. Motivation for this study

As one of the most populous countries, it is unfortunate to find more than 50% of the total Indonesian population of 237 million are either poor or vulnerable to becoming poor (Obaidullah, 2008). The two most prominent Islamic institutions – the *zakah* institutions and the Indonesian Islamic microfinance institutions (IIMFIs) – have played an important role in overcoming poverty in Indonesia. While the *zakah* institutions operating across the country have provided economic development programs to poor people (Somerville, 2007), the amount of *zakah* funding they generated was, however, inadequate for overcoming the country's rampant poverty.

IIMFIs, on the other hand, have provided loans to poor people to enable them to start small businesses. Recent observations suggest that the credit provided by IIMFIs has encouraged people to become micro entrepreneurs, with the number of people starting small businesses having increased from 482 in 2002 to 848 in 2005 (Cokro, Widiyanto, Ismail & Ghafar, 2008). These people's businesses grow gradually, enabling them to hire more employees – around two to three, on average. The household income also increased significantly, which is indicated by the increase in the amount of these micro-entrepreneurs' savings, their ability to afford sending their children to school and also increase their ability to pay for medical treatment (Cokro, Widiyanto, Ismail & Ghafar, 2008). A study conducted by Hadisumarto and Ismail (2010) aims to evaluate the effectiveness of Islamic micro financing confirms similar results. The business performance (business income, profit and asset growth) of small enterprises improved slightly after they were financed by IIMFIs. As a result, on average, their income increased by more than 100%. These evidences suggest that IIMFIs could potentially be a tool that will be useful in reducing poverty in Indonesia through empowering people to become economically independent, while at the same time reducing the number of unemployed.

The exceptional growth of IIMFIs during the last twenty years has placed Indonesia at the top of the world ranking for having the highest number of IMFIs, having exceeded that of Bangladesh and Pakistan (Karim, Tarazi & Reille, 2008). Although it is difficult to verify the accuracy of the statistic pertaining to the number of IIMFIs, the estimated number was about 4,000 by the end of 2012 (Perhimpunan BMT Indonesia, 2012). Although a number of IIMFIs were reported to have closed due to poor management and lack of governance (Seibel, 2004), but the majority still survive in providing financial services to the poor. This situation is similar to the result of survey on the risk and challenges encountered by 305 MFIs across 74 countries that accountability and governance are identified as a major factor that contributed to their failure (Labie, 2001; Centre for the Study of Financial Innovation, 2008).

The literature generally suggests that accountability and governance have been considered as a strategic tool for improving business performance and ensuring the continuation of the operation of any organisations (Aras, 2008; Labie & Mersland, 2011), including those in the microfinance sector (Champion, 1998; Rock, Otero & Saltzman, 1998). A governance system enables a control function in ensuring that funds are distributed according to their intended purposes (Hartarska, 2005), balancing the two goals of MFIs – social and economic (Kansiime, 2009) – and engendering trust to attract clients and depositors (CGAP, 2006). In other words, MFIs are required to become more accountable, as this accountability will lead the institutions toward achieving their goals and outcomes (Dixon, Ritchie & Siwale, 2006). Thus, research into accountability and governance practices in MFIs is urgently required in ensuring the sustainability of these institutions to help the poor, improve their impact on society and help to reduce poverty. As Schreiner (2000:425) suggests, "unsustainable microfinance organizations might help the poor now, but they will not help the poor in the future because the microfinance organizations will be gone"

In general, IMFIs across the world suffer from prudential regulation and supervision (Anwar, 2005). Hence, those institutions were encouraged to transform into regulated financial institutions in order to make them subject to banking regulations and the supervision of the central bank (Champion & White, 2001; Hishigsuren, 2006). Being a subject of supervision, they are required to have appropriate governance mechanisms in place in order to improve their accountability (Hartarska, 2009). In contrast, most IIMFIs were forced to transform their legal status in order to become cooperatives, registering with the Indonesian Ministry of Cooperative and Small and

Medium Enterprises (MoC-SMEs). However, they are not effectively supervised or regulated by the agency (Seibel, 2008). Despite the absence of government interventions, a number of IIMFIs succeeded in increasing their financial performance and expanding their business in reaching and serving a wider group of poor people in viable ways (Sakai, 2008). Therefore, understanding how accountability and governance are developed within successful IIMFIs could be a lesson that can be learned and replicated in other institutions. Adopting proper accountability and governance mechanisms will help IIMFIs to avoid having to cease operating in the future.

Unlike most of the world's MFIs, which require subsidies to finance loans and cover their operational costs (Hudon & Traça, 2008), IIMFIs have managed to develop with limited support, subsidies or grants from the government or donor institutions (Seibel & Agung, 2005). They have gradually succeeded in utilising the savings from depositors as the main source of their funds, then distribute those funds as loans to clients and receive the payment, including in the form of profit sharing, from them. The literature suggests that accountability and governance have been identified as the success factor of MFIs in improving their financial performance (Chaves, 1996; Hartarska, 2005; Hartungi, 2007; Smith-Hefner, 2007; Kyereboah-Coleman & Osei, 2008; Mersland & Strøm, 2009). Therefore, knowing the weaknesses of accountability and governance practices will help IIMFIs to improve their own practices and gaining trust. Obtaining trust from society will bring about an increase in the opportunity to reach more depositors clients and other capital providers (Hartarska, 2009) which are essential resources in ensuring sustainability of their operations in the long term.

1.3. Research objectives and research questions

The issue of accountability and governance in the context of MFIs has been discussed separately in the literature. Studies of accountability focus mainly on discharging accountability through formal financial reporting (Vatikiotis, 1998; Wahyuni, 2008) or informal oral reporting (Dixon, Ritchie & Siwale, 2006) and examining the quality of financial reporting (Hyndman, McKillop, Ferguson & Oyelere, 2002; Wahyuni, 2008). On the other hand, corporate governance has been identified as a key success factor in enhancing the viability of MFIs (Mersland, 2011). Therefore, studies of governance have predominantly focused on examining the relationship between different aspects of the governance mechanism (such as board size, governance model, ownership structure) and MFI performance (Hartarska, 2005; Hartarska & Nadolnyak, 2007; Kyereboah-Coleman & Osei, 2008; Mersland & Strøm, 2009; Aboagye & Otieku, 2010). The results of those studies generally confirm that the governance mechanisms in place have contributed significantly to improving the MFIs' performance in terms of profitability, outreach and sustainability.

While Laughlin posits that accountability and governance should be understood in the context in which they are practised (1990), there is however limited research into the way in which accountability and governance mechanisms are developed and practised within MFIs in general, and IMFIs in particular. Hence, to narrow the gap in the accountability and governance literature, as well as the MFI literature, this study aims to explore the accountability and governance mechanisms that are practised in selected IIMFIs. Since the practice is socially constructed, it is important to understand how the sector in general developed and influenced the practices at the organisational level. Therefore, the research objectives and research questions of this study are as follows:

Research Objective 1: To examine the historical development of the Islamic microfinance sector in Indonesia.

Research Question 1 : How did the *field* of Islamic microfinance emerge and develop in Indonesia?

Research Objective 2: To investigate the way in which accountability and governance mechanisms are developed and practised within selected IIMFIs.

Research Question 2 : How do *capital* and *habitus* affect the *practice* of accountability and governance in the two selected cases of IIMFIs?

The next section briefly describes how the two research objectives stated above will be achieved. Chapters 5 and 6 will discuss in further detail the theoretical framework and research design adopted in this study.

1.4. Research method

This study follows the argument that accountability and governance are socially constructed (Sinclair, 1995; Abdul-Rahman & Goddard, 2003) through internal and external systems (Yakel, 2001). The internal system refers to technical knowledge, individual values and professional standards, while the external system comprises the economic and socio-political system, regulation and oversight authorities (Al-Habil, 2011). Therefore, understanding the social construction of accountability and governance practices requires an examination of the context, including the socio-economic and political situation (Yakel, 2001) as well as the organisational history and culture (Haniffa & Cooke, 2002; Overall, Tapsell & Woods, 2010).

Traditional theories of governance are deemed unable to address the question of how accountability and governance practices are constructed and re-constructed over time. Accordingly, this thesis adopts Bourdieu's *theory of practice* (Bourdieu, 1977, 1992), comprising the concepts of *field*, *habitus* and *capital*, in understanding how a particular *practice* is produced and reproduced.

The concept of *field* is employed for sector-level analysis to address the first research objective. This concept helps in examining the historical development of Islamic microfinance in Indonesia as an external system that affects the construction of accountability and governance practices within selected IIMFIs. Examining this development requires analysis of the economic and socio-political situation relating to the emergence and development of IIMFIs.

Therefore the historical research method is considered the most appropriate to provide a narrative history of the emergence and development of the Islamic microfinance sector. This was done by interviewing people who were deemed have extensive knowledge of the development of IIMFIs. These people were selected from the institutions that played significant roles in the emergence and development of IIMFIs: the chairman of an association of IIMFIs called ABSINDO, the chairman of a business incubator centre for the establishment of IIMFIs called PINBUK, the chairman of the Economic and Entrepreneurship Council of *Muhammadiyah*, and staff from Indonesia's Ministry of Cooperative and Small and Medium Enterprises

(MoC-SMEs). Secondary resources have been utilised, primarily from published academic research, relating to the socio-political situation and the IIMFI initiative. The analyses of interview transcriptions and relevant journal articles were conducted by examining the relationships among four aspects: the genesis of the Islamic microfinance sector, its position among Islamic financial services, the struggle within this sector and the current dynamics of the sector (Kay & Laberge, 2002).

Furthermore, the concepts of *capital* and *habitus* have been employed in discussing organisational-level analysis, and hence are related to the second research objective, which is to understand how accountability and governance *practices* are developed and practised within selected IIMFIs. Accountability and governance practices are dynamic rather than static. They change over the period following the growth of an organisation in terms of age and size (Smith, Mitchell & Summer, 1985), therefore the construction of accountability and governance *practices* involves a continuous process (Fisher, 2004; Jepson, 2005). Since the historical and cultural context affects such construction (Haniffa & Cooke, 2002; Overall, Tapsell & Woods, 2010), the ethnographic method is deemed the most appropriate to investigate the construction of accountability and governance *practices* within selected IIMFIs.

The two cases for this study were selected to represent two categories of IIMFI: BMT (*Baitul Maal wat Tamwil*), which is the majority form of 95% of IIMFI, and BTM (*Baitul Tamwil Muhammadiyah*), which accounts for 5% of IIMFIs (Seibel & Agung, 2005). For each case, two criteria were established to determine the ability to continue their operations and the organisation’s growth: it has been operating for more than 10 years and the organisational assets must be more than IDR 1 billion.[3] Due to the fact that no information is publicly available on the internet about IIMFIs, the selection of the two cases was based on recommendations from Indonesian colleagues and the chairman of Asosiasi BMT Indonesia (ABSINDO), Induk Koperasi Syariah (INKOPSYAH) and Pusat Inkubasi Usaha Kecil (PINBUK). Accordingly, BMT A and BTM B were chosen.

The research was conducted by interviewing members of the boards, the management and members of low level staff and observing the behaviours and main activities at the front office, including daily religious *practices*, as well as recording transactions. The secondary data from internal documents such as the company profile, annual financial reports and product pamphlets were used to support the information gained during the interviews and observation. The data from interview transcriptions, observation and secondary documents was analysed by linking it to the research questions, coding the data based on the four themes of Bourdieu's concepts: *field*, *capital*, *habitus* and *practice*. The data was then interpreted using narrative analysis and formulating a thick description of the story. The next section provides a summary of the findings.

1.5. Summary of findings

The concept of *field* helps to achieve the first research objective and provides evidence that the Islamic microfinance sector in Indonesia changed and developed over the period under study. The historical development was traced, primarily relating to the initiative of microfinance based on Islamic teaching, the Islamic

[3] About GBP 50,756, exchange rate then being 1 GBP = IDR 19,702 (1st May 2015)

awakening movement, the socio-economic conditions and financial reforms. As a result, the narrative of the historical development of the field of Islamic microfinance in Indonesia is divided into four periods: the Dutch period, post 1980–1990, post 1990–2000 and the period post 2000.

The genesis of Islamic financial services can be traced back to Dutch colonisation. It started from the *Baitul Maal* (house of treasure/money), which collected funds from the mosque to help poor people who lived in the area. This initiative grew exceptionally well, and was formalised to become a commercial and interest-based bank. Later, this institution was nationalised into Bank Rakyat Indonesia after Indonesia's independence day, and is considered the most successful microfinance model in the world (Seibel, 2005b).

The second period of post 1980–1990 is important in the history of Islamic microfinance in Indonesia for two main reasons: the Islamic awakening movement and the financial reforms. The Islamic resurgence movement started from the Institute of Technology Bandung to bring about Islam as the way of life, including in business, by establishing a pilot project of *Baitul Tamwil* Teknosa. Years later, former activists established the ICMI (the association of intellectual Muslims), which actively promoted the establishment of Islamic banks in Indonesia. During the second period, the financial reforms that provided for the inception of microfinance regulation in Indonesia were enacted.

The third period of post 1990–2000 is marked by the establishment of the first Islamic bank in Indonesia, well known as the *Bank Muamalat Indonesia* (BMI), in

1991. The growth of the BMI was stagnant due to tight banking regulations. To fulfil the demand for Islamic financial services in rural areas, the Islamic microfinance institution called BMT (*Baitul Maal wat Tamwil*) was introduced. Such institutions were established throughout Indonesia by the groundwork of PINBUK (the incubation centre for small businesses) and the number of BTMs reached almost 3,000 by the end of 2000 (Seibel, 2004). However, there was a regulatory change in 1999 that brought BMTs into being in the fourth period of post 2000. It was marked by the transformation of BMTs into cooperatives and the beginning of the establishment of an association that functions as a regulator for their members.

The changes in the *field* of Islamic microfinance, primarily during the third and fourth periods, affected the accountability and governance *practices* in the two selected IIMFIs. The internal factor of the growth of different types of *capital* (economic, cultural, social and symbolic), imbued by the *habitus*, had changed accountability and governance *practices* within these two IIMFIs. The development of such *practices* corresponded with the different stages of organisational growth suggested by Smith et al. (1985). Both institutions in this study have evolved through three stages. In general, they started from a small experimental project, moved to formalisation of the institution and flourished into a big organisation in terms of assets. Such developments accordingly require the institutions to adopt different accountability and governance mechanisms. Overall, due to a lack of appropriate supervision from the government, both institutions developed their own accountability and governance mechanisms as an attempt to ensure their sustainability to continue their operations in the future.

1.6. Contributions of this study

Despite some of the limitations of the current study, as discussed in Chapter 10, it adds new knowledge and makes significant contributions to, the accountability and governance as well as the microfinance literature. Furthermore, unlike most studies that focuses on only one aspect of the Bourdieusian theory of practice, this study incorporates the triad of concepts in a single study and adopts ethnographic research methods to achieve the objectives of the study. Each of these is highlighted below.

Literature

- This study complements the accountability and governance literature by bringing together the two issues in a single piece of research. By doing so, the interrelationship between accountability and governance *practices* is revealed. Accountability and governance practices in Islamic organisations are driven more by felt accountability as part of fulfilling the function of trust to fellow humans and, more importantly, to Allah in the hereafter. The former is related to the daily operational practices while the latter concerns the strategic issues of how an organisation is controlled and directed, hence they are inseparable and it should be discussed together.
- This study also contributes to accountability and governance research in a unique context, Islamic microfinance institutions in Indonesia that operate within an unregulated environment. There is no adequate supervision from the authorised body and no accounting and reporting standards are available for this sector. In fact, a large number of IIMFIs are running their businesses as banks and have accumulated a significant amount of assets.

- This study adds to the literature on accountability and governance in a cultural and religious setting, whereby the embedded values, beliefs and knowledge affect the *practices* of accountability and governance. This research was conducted in IIMFIs in which Islamic values have permeated their mind set and behaviour. In turn, this disposition influences the way they manage the organisation, including its accountability and governance *practices*. Therefore, this study strengthens the argument that accountability and governance are socially and subjectively constructed by the social context within which they operate.
- This study demonstrates the dynamic aspect of accountability and governance, an area that has been neglected in accountability and governance research, by exploring the construction of accountability and governance practices in different phases of organisational growth. It also confirms that the construction of accountability and governance *practices* involves a continuous and interactive process between the organisational level (IIMFIs) and the sector level (the field of Islamic microfinance).
- This study makes contributions in expanding the existing literature on MFIs, both conventional and Islamic MFIs, in various ways. In terms of topic, the study expands the scope of research on MFIs, which is dominated by studies of the impact of MFIs on poverty, the roles of subsidies to MFIs and high interest rates among MFIs. While few studies attempt to investigate the impact of existing governance on MFIs' performance, this study offers an understanding of how accountability and governance *practices* are constructed. In terms of context, while most of the research on MFIs is conducted within conventional (interest-based) MFIs in Latin America, Africa or South Asia, this study is conducted in

Islamic (interest-free) MFIs in Indonesia, which is considered to have the greatest diversity of microfinance institutions in the world (Seibel, 2004). Finally, while previous research on MFIs has not been guided by a particular theory, this study adopts a theory of practice that proposes different lens for understanding the development of accountability and governance practices within microfinance institutions.

Theory

- This study complements research on accountability and governance as a social practice by adopting the theory of practice developed by Bourdieu (1977). The concept of *field* in the theory is useful in explaining how the Islamic microfinance sector emerged, developed and influenced accountability and governance practices within IIMFIs. Moreover, the concepts of *capital* and *habitus* are useful in demonstrating how such practices have developed parallel with the growth of various forms of *capital*, as suggested in the theory and imbued by the organisations' *habitus*.
- By linking Bourdieu's theory of practice (1977) with organisational growth, this study provides unique lens for understanding how accountability and governance *practices* changed and developed over the period. The theory of practice has helped to explain the construction of accountability and governance *practices* in a specific temporal and spatial setting; that is, Islamic microfinance institutions in Indonesia. Since accountability and governance practices have developed as the result of growth in *capital*, the different phases of organisational growth help to elucidate such development.

- While Bourdieu's theory has been adopted widely in accounting research, only a few studies utilise the triad of concepts of *field*, *capital* and *habitus* together in a single piece of research. This study follows this trajectory by incorporating these three concepts to help in understanding the construction of accountability and governance *practices* within organisations. As Bourdieu suggests, *practices* result from the relations among *habitus, capital* and *field*. Therefore, these three concepts should be discussed in relational ways.
- The main aim of Bourdieus theory of practice is to overcome the dualism within between objectivist (as exemplified by the work of Lévi-Strauss) and subjectivist tradition (as proposed by Sartre) (Grenfell, 2008c). By bringing Bourdieu's theory of practice into an Islamic context, such theory goes beyond the subjectivity and objectivity dualism. This is because the Islamic view is based on the *Shari'ah Islamiyah* paradigm that stems from the Unity of Allah and encompasses five concepts of unity: Allah, truth, creation, humanity and life (Safi, 1993).

Research method

- This study complements the growing body of ethnography in accounting research. This method is considered a valuable way to investigate how accounting practices are implemented in an actual organisational setting. Doing so will improve the understanding of the specific context in which they are practised (Laughlin, 1990).
- This study differs from mainstream research on accountability and governance in MFIs, which is dominated by the quantitative approach. Since the nature of

this study is exploratory, it provides insights on broader aspects of governance or accountability mechanisms that tend to focus only on financial performance.

Policy making

- The findings of this study suggest that the government needs to undertake efforts to regulate IIMFIs by establishing appropriate regulation, including the provision of mechanisms for supervision in order to strengthen the prudential management of IIMFIs.
- In addition, this study also suggests that IIMFIs need to improve the capacity, knowledge and skills of their human resources through a continuous training program to prepare them for challenges and changes in business in the future.

1.7. Structure of the thesis

This thesis is comprised of five parts and ten chapters as illustrated in Figure 1-1.

Part I, Chapter 1 introduces and summarises the thesis. It explains the background and motivation for this study as well as the research method, a summary of the findings and its expected contributions.

Part II of the thesis comprises the three chapters of the literature review and the context of the research.

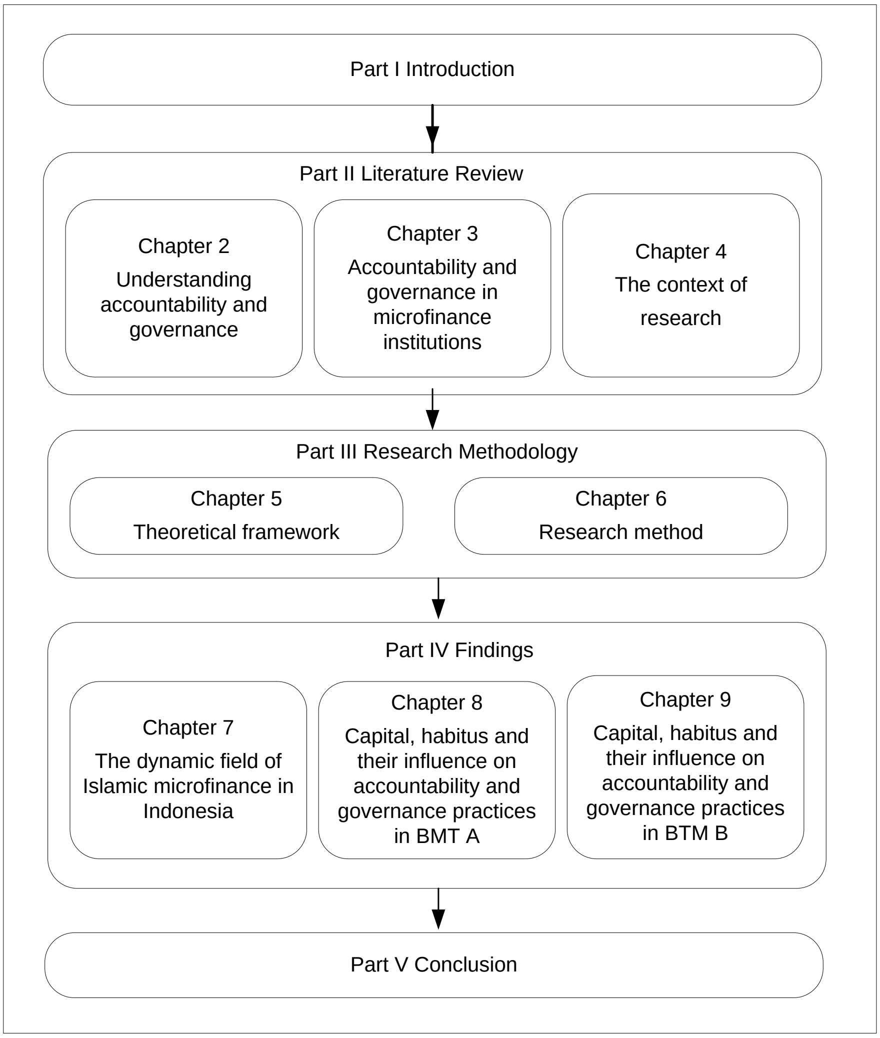
Chapter 2 presents a review of the relevant literature on accountability and governance from both a general and an Islamic perspective. In particular, it attempts to define accountability from a wide range of terms and definitions and to map the four elements of accountability. The second part of this chapter also explains the different perspectives on governance by presenting various theories of governance.

The mechanisms of accountability and governance in different types of organisations are elaborated, including a summary of such practices. This chapter also discusses the *shari'ah* Islamiyah paradigm in order to understand accountability and governance concepts from the Islamic perspective. Accountability and governance from the Islamic perspective goes beyond the traditional view that the ultimate accountability is to God. The comparison of both perspectives is presented in this chapter, followed by the concept of the social construction of accountability and governance.

Chapter 3 presents the accountability and governance practices in a specific context, microfinance institutions. The first part introduces an overview of the characteristics of MFIs, both conventional and Islamic. This is followed by discussion of the importance of and main issues regarding accountability and governance in this area. The chapter reviews studies on accountability and governance in MFIs, which leads to identifying the research gaps in terms of literature, methodology and theory.

Chapter 4 gives an overview of the context of the research. It provides the socio-economic and political background as well as a description of poverty in Indonesia. The initiatives for alleviating poverty are discussed, primarily the initiative from the two biggest Islamic mass organisations in Indonesia: the *Nahdlatul Ulama* and *Muhammadiyah*. The sociological difference between these two institutions is elaborated in an attempt to understand the different approaches in their social movements, including in their financial services.

Figure 1-1 The structure of the thesis



Part III of the thesis discusses the research methodology and comprises two chapters on the theoretical framework and the research method.

Chapter 5 presents the theoretical framework adopted to achieve the research objectives of this research. The chapter outlines Bourdieu's theory of practice and explains the four concepts therein: *practice, field, capital* and *habitus*. The different studies of accounting adopting Bourdieu's conception are reviewed to present the merits of Bourdieu's theory in accounting research, including this research.

Chapter 6 outlines the research method of this study. It begins by presenting different alternative methodologies for researching accountability and governance: mainstream, interpretive and critical approaches. This is followed by an explanation of the philosophical stance of this research. The two research designs are discussed: a narrative history to address the first research objective in examining the development of Islamic microfinance, and the ethnographic approach to examine the construction of accountability and governance practices within Islamic MFIs.

Part IV of this thesis comprises three chapters of empirical findings.
Chapter 7 presents findings that address the first research objective by examining the historical development of the *field* of the Islamic microfinance sector in Indonesia. The analysis of Indonesia's socio-economic and political situation identifies four major fundamental changes that led to the findings being presented in four periods: the Dutch period, post 1980–1990, post 1990–2000 and post 2000. The findings demonstrate that the emergence and development of Islamic microfinance in Indonesia are inseparable from the socio-economic and political situation. Therefore, the *field* is dynamic rather than static.

Chapter 8 presents the findings from the first case study in addressing the second research objective regarding how accountability and governance mechanisms are developed and practised within BMT A. This chapter begins with the historical background of BMT A in entering the *field* of Islamic MFIs, then continues to elaborate on the organisational habitus of its perception of business as a medium of *dakwah* (Islamic proliferation), loyalty to the institution that represents the attributes and culture that it practises. The identification of different types of capital owned by

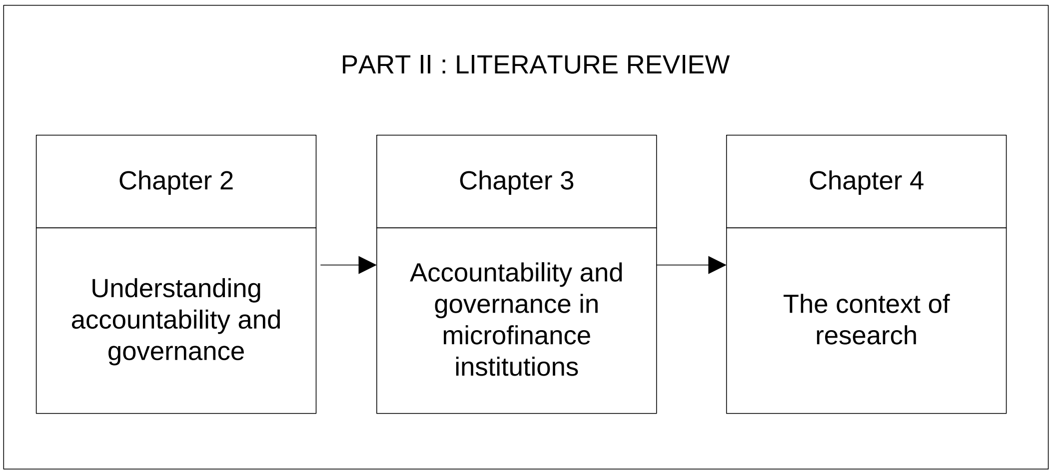
BMT A is discussed, followed by the development of accountability and governance practices in the three different phases of organisational growth.

Chapter 9 presents the findings from the second empirical case to address the second research objective regarding the construction of accountability and governance *practices* within BTM B. The first section discusses the history of BTM B from when it started to enter the field of Islamic microfinance, following by explaining the *habitus* that permeated in the construction and re-construction of accountability and governance *practices*. The different types of *capital* are also discussed and the last section presents the evolution of accountability and governance practices adopted by BTM B in the first, second and third stages of its growth.

Finally, Chapter 10 provides a review of the main points of this study by bringing together a summary of the findings and their implications, as well as recommendations for the development of IMFIs in Indonesia. Reflections in terms of the limitations of this study and avenues for further research are also offered.

PART II LITERATURE REVIEW

Part II of the thesis comprises three chapters intended to present the contextual understanding related to this research. Chapter 2 reviews the relevant literature on accountability and governance in general and from an Islamic perspective since the context of this study is based on Islamic microfinance institutions. This includes the different perspectives and models of accountability and governance and how they are practiced in different types of organisations. Chapter 3 discusses accountability and governance in the specific context of microfinance institution and how the literature covers the issue of accountability and governance in such institutions. By doing this, the literature gaps can be identified. Chapter 4 briefly explains the country context of this research to understand the important role of Islamic microfinance institutions as well as provide the historical background of the selected institutions for this study



CHAPTER 2 UNDERSTANDING ACCOUNTABILITY AND GOVERNANCE

2.1. Introduction

The aims of this chapter are to review the relevant literature on accountability and governance both in general and from an Islamic perspective. Moreover, this chapter also discusses the accountability and governance practices in different sectors. '*Accountability and governance'* are considered to be a new planetary vulgate (Bourdieu & Wacquant, 2001; Cooper & Johnston, 2012) and thus vocabulary seems to have sprung out of nowhere and, most importantly, their "effects are all the more powerful" (Bourdieu & Wacquant, 2001:2).

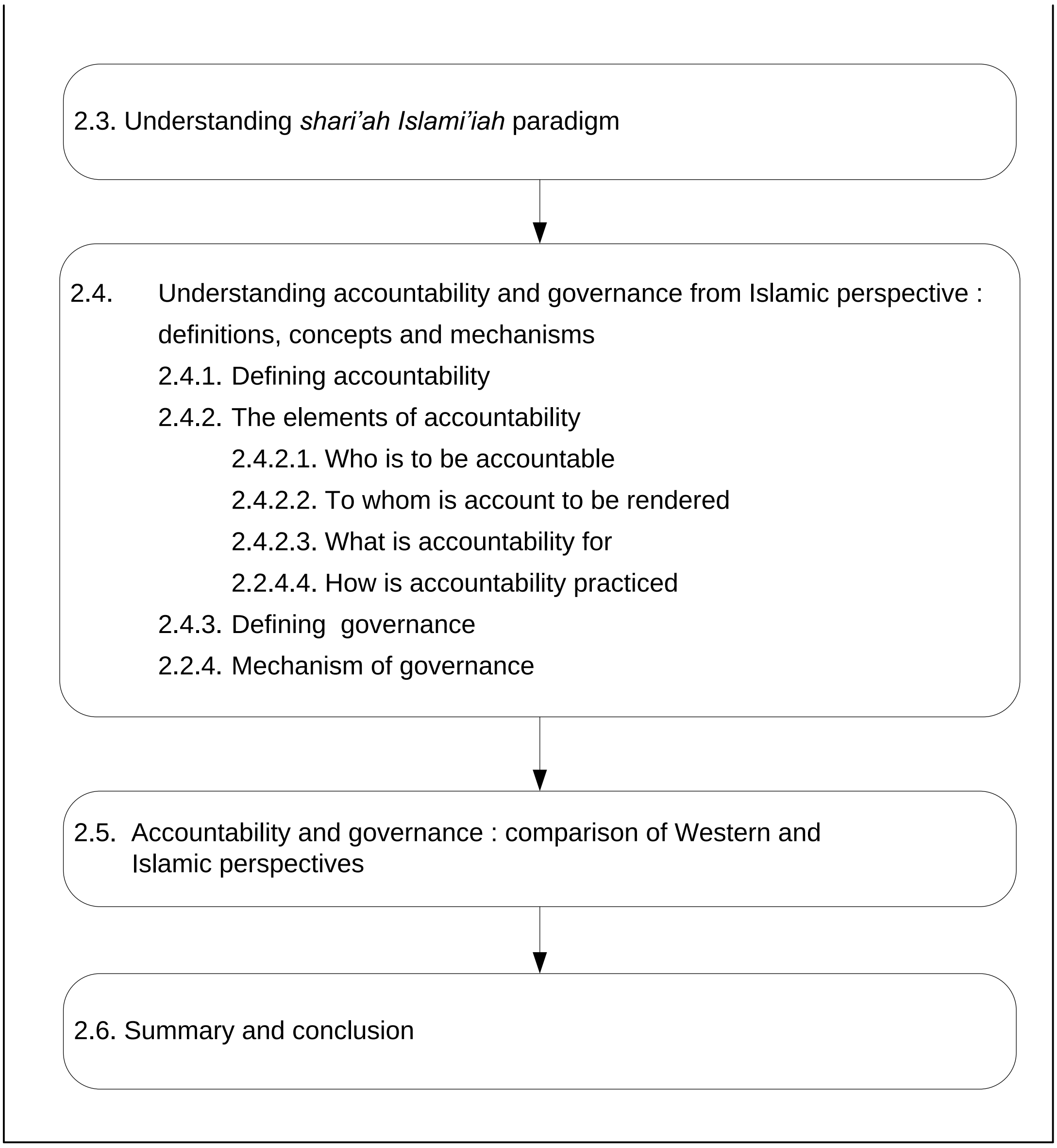
Therefore, understanding the meaning, concept, model and mechanism of accountability and governance will help us know how they are practised in different contexts. This chapter proceeds as follows. The first section explains the definitions, concepts, models and mechanisms of accountability and governance in general. This section is followed by a description of accountability and governance practices in various sectors. Section 2.3 discusses the *shari'ah Islamiyah* paradigm that underpins Islamic beliefs in order to gain an understanding of accountability and governance from an Islamic perspective, which is then examined in more detail in section 2.4. The chapter ends with a summary and conclusion. The structure of this chapter is illustrated in Figure 2-1

Figure 2-1 The structure of Chapter 2

2.1. Introduction

2.2. Understanding accountability and governance : definitions, concepts and mechanisms

- 2.2.1. Defining accountability
- 2.2.2. The elements of accountability
  - 2.2.2.1. Who is to be accountable
  - 2.2.2.2. To whom is account to be rendered
  - 2.2.2.3. What is accountability for
  - 2.2.2.4. How is accountability practiced
- 2.2.3. Defining corporate governance
- 2.2.4. Perspectives and different model of governance
  - 2.2.4.1. Agency theory
  - 2.2.4.2. Stewardship theory
  - 2.2.4.3. Stakeholder theory
  - 2.2.4.4. A democratic perspective
  - 2.2.4.5. Resource dependency theory
  - 2.2.4.6. A managerial hegemony theory
- 2.2.5. Accountability and governance mechanism in different types of organisations
  - 2.2.5.1. For profit organisation (FPO)
    - 2.2.5.1.1. Accountability practice
    - 2.2.5.1.2. Governance practice
  - 2.2.5.2. Non profit organisation (NPOs)
    - 2.2.5.2.1. Accountability practice
    - 2.2.5.2.2. Governance practice
  - 2.2.5.3. Social enterprises (SEs)
    - 2.2.5.3.1. Accountability practice
    - 2.2.5.3.2. Governance practice



2.2. Understanding accountability and governance: definitions, concepts, and mechanisms

Accountability and governance are interlinked (Jepson, 2005). Governance refers to the system and process in ensuring that organisations are directed, controlled and made accountable; therefore it focuses on the structures and strategic issues related to decision making and company control (Tricker, 2009a). On the other hand, accountability is a sub-set of governance and it is concerned on the everyday activities of account giving involving reporting, monitoring and supervising organisational members (Keasey & Wright, 1993). In other words, governance systems and its mechanisms will help to ensure that all members of the organisations are made accountable, so that organisations can be managed effectively, efficiently and ethically (GMCA, 2013). Hence, it is not surprising that accountability has become a topic of concern within the governance literature (Erkkilä, 2007) and considered as a hallmark of governance (Bovens, 2007b). The American scholars have even used accountability and governance interchangeably (Bovens, 2007a).

2.2.1. Defining accountability

Accountability is a ubiquitous concept. Historically, the idea of accountability corresponded to an organisation's accounting practice in terms of book-keeping (Dubnick, 2002). From a technical aspect, the concept of accountability has evolved to become more of a sociological and organisational perspective (Mulgan, 2000a). The issue of accountability has been discussed in many subjects, such as politics, economics, business, public policy and education. However, the term 'accountability' suffers from having an imprecise meaning (Patton, 1992), and can be used to mean different things to different people (Bovens, 2007a). Accountability is also a multifaceted and elusory concept (Sinclair, 1995), and a single and precise definition of accountability is therefore unlikely.

Accountability is defined simply as "giving and demanding of reasons for conduct" (Roberts & Scapens, 1985:447) by providing information as a raw material for the account (Stewart, 1984). However, accountability is not limited to "the duty to provide an account" (Gray, Dey, Owen, Evans & Zadek, 1997:334), as information does not constitute the whole of accountability. Accountability requires more actions in order to explain, justify and take responsibility (Cooper & Owen, 2007). Therefore, "accountability is a process through which an organisation actively creates, formally structure, balance relationships with its diverse stakeholders" (Hammer & Lloyd, 2011:32). More recently, Roberts (2009:966) argues that accountability is not the mere achievement of a pre-determined set of categories, but that it "involves active enquiry-listening, asking questions, and talking – through which the relevance or accuracy of indicators can be understood in context". This is also known as 'intelligent accountability' (O'Neil, 2002). While conventional accountability captures performance only at periodic snapshots, intelligent accountability extends over a period of time, hence it is easier to detect any manipulation (Roberts, 2009).

The different definitions of accountability above can be understood from a number of perspectives. Since the scope and meaning of accountability has been expanded in unprecedented ways, the concept of accountability is therefore an ever-expanding one (Mulgan, 2000a). Despite the wide range of accountability perspectives, there are three main essences of accountability. First, accountability is a social and contractual relationship (Laughlin, 1990; Bovens, 2007a) between the accountee, who holds to account, and the accountor, who accounts and is held to account (Stewart, 1984; Bovens, 2007a). Secondly, accountability is based on the bond of accountability (Stewart, 1984) that clarifies what the accountor is accountable for (Patton, 1992). Thirdly, accountability is a process (Fox & Brown, 1998; Fisher, 2004) that constitutes a concrete practice of account-giving to explain and justify the accountor's conduct.

2.2.2. The elements of accountability

Since there is no single definition that effectively encompasses the entire idea of accountability, the literature suggests that understanding accountability can be approached by disentangling four fundamental questions: '*Who is'* to be accountable (accountor), '*To whom*' is account to be rendered (accountee), '*For what*' is accountability necessary (the standard), and '*How is*' accountability practised (the mechanism) (Haque, 2000; Newell, 2006; Bovens, 2007a; Shaoul, Stafford & Stapleton, 2012). Understanding those aspects will help us to understand the nature of accountability as both a social relationship and a process.

2.2.2.1. Who is to be accountable

The primary element of accountability is the parties involved (Goodin, 2003), or the account-giver or accountor whose obligation it is to explain reasons, justify actions and give accounts (Newell, 2006). However, it is not easy to unravel who should account for their actions, as many people may contribute in many different ways to decisions and policies within an organisation. It is known as 'the problem of many hands' (Bovens, 2007c). The literature has identified that depending on the context, the accountor can be categorised into two levels: individual and organisational (Gray, Owen & Adams, 1996; Buhr, 2001).

Accountability at the individual level in an organisation is continually being researched and very often becomes a domain within psychology and human-resource management. The accountability of an individual as a member of an organisation is recognised in terms of positive behaviours that contribute to the success of an organisation (Hall, Frink, Ferris, Hochwarter, Kacmar & Bowen, 2003). To do so, an organisation creates a mechanism which starts by establishing an employment contract, providing training, defining an individual's responsibilities, setting a formal reporting relationship, and monitoring performance with reward or punishment (Frink & J.Klimoski, 2004).

On the other hand, the extent to which individuals perform their accountability is dependent on their perceptions of accountability, which is referred to as 'felt accountability' (Ammeter, Douglas, Ferris & Goka, 2004; Hall, Zinko, Perryman & Ferris, 2009). This perception includes formal aspects of the individual's job, as written in their job description, as well as informal aspects of what they should do to follow the organisational norms. Empirical studies demonstrate that the effects of accountability can be both negative and positive. Too much accountability can cause employee stress and increased job tension. Hence, any accountability system should be designed to provide balance between controlling individual behaviour and maximising the achievement of organisational goals (Hall, Zinko, Perryman & Ferris, 2009).

While studies of individual-level accountability are scant, organisational or corporate accountability has dominated the literature in this field. The root of corporate accountability is based on the idea of organisational legitimacy, that "an institution which wield practical power...must be accountable for its purpose and its performance by criteria not in the control of the institution itself" (Benston, 1982:87). Organisations are seen as a corporate body with independent legal status, which means that they can therefore perform as unitary actors and, accordingly, can be held accountable (Bovens, 2007c). In this context, a manager who has control of the entity is acting to represent an organisation in order to account for the collective actions toward various stakeholders, depending on the sector in which the organisation is embedded.

2.2.2.2. To whom is account to be rendered

The relationship between accountor-accountee is much wider than the relationship between shareholder-manager (Benston, 1982), which merely focuses on corporate accounting and finance. Accountors deal with multi-accountabilities, which require them to account to various elements. This process is made even more complicated, because different groups have different expectations. This issue is referred to as ‘problems of many eyes’, i.e. to whom they are to account (Bovens, 2007c). Traditionally, studies on accountability have been heavily influenced by the principal-agent perspective (Brennan & Solomon, 2008). From this point of view, the accountability relationship is defined as being between only the management, who are entrusted to manage the corporation and its shareholders. However, there is growing interest from scholars to broaden the research, from a focus on shareholder-centric to stakeholder-orientated. Corporations are seen as being part of social institutions, so they should, accordingly, take into account the wider groups who may be affected by the organisation (Wang & Dewhirst, 1992).

In short, organisations are now required to be accountable to three inclusive groups: shareholders, stakeholders and society in general (Benston, 1982). Therefore, in order to demonstrate ‘*to whom*’ an organisation should be accountable, the literature suggests the following dimensions of accountability: *upward, inward* and *downward* accountability (Edwards & Hulme, 1995), or *vertical versus horizontal accountability* (Schillemans, 2008).

The concept of *upward, inward and downward accountability* (Edwards & Hulme, 1995) is largely conceptualised by the non-profit sector, particularly non-government organisations (NGOs). NGOs are described as being autonomous, self-governing and non-profit making, whose main goals are to promote wellbeing of others (Gray & Bebbington, 2006). In its operation, the accountor should meet the demand from multiple stakeholders: patrons, clients, and themselves (Edwards & Hulme, 1995).

Upward accountability refers to an organisation being held accountable by above parties – those who provide a financial and legal base such as donors, government and foundations; *downward accountability* refers to an organisation's accountability to its beneficiaries, i.e. those to whom they provide a service; and *inward accountability* implies an organisation's accountability to itself for the conformity of its own activities with its own values and mission statement. Ideally, the accountability relationship between an organisation and its various stakeholders is equal. However, accountability is, in fact, "skewed to the most powerful constituencies" (Chritensen & Ebrahim, 2006:197). The donors have more power to impose accountability through financial leverage (Lloyd, 2005). Similarly, the government could enforce accountability through establishing a regulatory framework. In this situation, the beneficiaries of an organisation are the powerless stakeholders, as they do not have the instruments necessary to compel accountability. As a result, accountability to beneficiaries is unclear and mainly shaped by the moral obligations of the individual organisation (Lloyd, 2005).

The dimension of accountability can also be seen from the *vertical* and *horizontal* accountability perspectives (Schillemans, 2008). This concept has been used widely in the political discourse as a check and balance between the state and its citizens (Kenney, 2003). *Vertical accountability* is a traditional form of accountability, in which subordinates provide reports to a superior (Schillemans, 2008). The majority of political accountability arrangement is based on this form, which follows the hierarchical chain of delegation (Bovens, 2007a). On the other hand, *horizontal accountability* occurs on the outside of the hierarchical relationship between principal and agents (Schillemans, 2008), such as media, independent evaluators, interest groups and commissioners.

2.2.2.3. What is accountability for

The question of '*what is accountability for*' concerns different aspects of conduct, as well as what kind of information is to be provided by the accountor (Bovens, 2007a). This aspect is known as '*field of accountability*', which describes activities covered by the bond of accountability (Stewart, 1984). Accountability can be enforceable if the field of accountability has been clearly defined. Depending on the nature of accountability; there are different fields or forms of accountability (Stewart, 1984; Roberts, 1991; Sinclair, 1995; Bovens, 2007a). Table 2-1 summarises the various categories of 'what accountability is for'.

Table 2-1 Different categories of '*what accountability is for*'

Field of accountability	Resume
Accountability for legality/compliance	Accountability based on specific responsibilities, both formally and legally, bestowed upon authorities, and guided by legal standard and scrutiny.
Accountability for procedure	Accountability to evaluate whether the processes or activities are in compliance with the standard of procedures. Similar terms that have been used to refer to this field of accountability include: *process* (Stewart, 1984), *administrative* (Bovens, 2007a) and *managerial* (Sinclair, 1995).
Accountability for resources	Accountability to ensure that resources are utilised properly and in the manner authorised. Similar terms that have been used to refer to this accountability include: *input* (Patton, 1992), *probity* (Stewart, 1984), *financial* (Sinclair, 1995; Bovens, 2007a) and *reasonableness* (Daniels & Sabin, 2008),
Accountability for performance	Accountability to assess the achievement of organisational goals. Similar terms that have been used to refer to this accountability include: *program* (Stewart, 1984), *result* (Steven, 2004), *outcome* (Patton, 1992)

Source: Author

These different types of accountability lead to different types of information to be disclosed (Patton, 1992), as the type of information for procedural accountability might differ from accountability for resources. The literature has supported organisations to provide various types of reports (Buzby, 1974) to meet the different needs of information. However, this could be too costly (Patton, 1992). To overcome this issue, therefore, organisations are pressured to provide both financial and non-financial information (Hyndman, McKillop, Ferguson & Oyelere, 2002), as well as disclose information as much as they can in the annual reports (Marston & Shrives, 1991).

2.2.2.4. How is accountability practiced

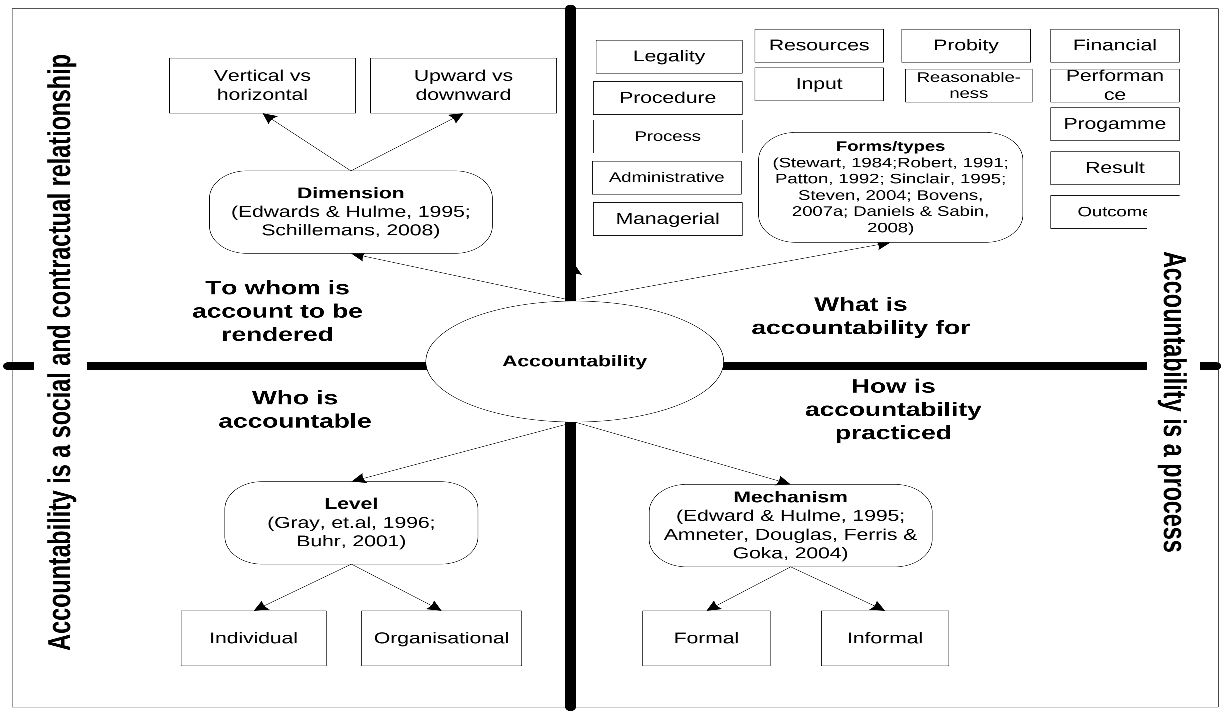
The ways in which accountability is practised refers to the accountability mechanism, which is defined as "the devices that serve to secure whatever it is (action, result or intention) for which people are accountable" (Goodin, 2003:365) and to control the behaviours of employees and organisational units (Ammeter, Douglas, Ferris & Goka, 2004). Thus, the mechanism of accountability focuses on the ways in which the accountors give account for their conduct.

There are a number of accountability mechanisms that exist in the literature. From the perspective of public administration, Goodin (2003) suggests that the accountor can be held accountable through the hierarchical system, competitive discipline or cooperative networking. The first mechanism operates through the superior-subordinate relationship, while the second runs through the competing of interests, and the third applies through the sharing of common values, beliefs and norms (Goodin, 2003).

However, a great number of studies divide the accountability mechanism into *formal and informal* (Edwards & Hulme, 1995; Ward, Johnson, Ward & Jones, 1997; Ammeter, Douglas, Ferris & Goka, 2004; Dixon, Ritchie & Siwale, 2006; Hall, Bowen, Ferris, Royle & Fitzgibbons, 2007; Romzek, LeRoux & Blackmar, 2009; Boland & Schultze, 2012). '*Formal mechanism*' refers to the system applied for the purpose of assuring compliance, monitoring and evaluating performance in order to discharge accountability for external users (Hall, Bowen, Ferris, Royle & Fitzgibbons, 2007). This includes financial statements and other forms of performance evaluation (Ammeter, Douglas, Ferris & Goka, 2004; Ebrahim, 2005; Chritensen & Ebrahim, 2006).

Beyond this standard mechanism, there are also organisational cultures, norms, values, beliefs and open dialogues that also shape accountability practices; this is known as '*informal mechanism*' (Chritensen & Ebrahim, 2006; Hall, Bowen, Ferris, Royle & Fitzgibbons, 2007). The *formal mechanism of accountability* is deemed to produce more positive organisational outcomes (Hall, Bowen, Ferris, Royle & Fitzgibbons, 2007), because it provides clear standards for reward and punishment of the correct and incorrect behaviours that can either cause people to carry out or prevent people from carrying out inappropriate behaviour (Mitchel, Hopper, Daniels, Falvy & Ferris, 1998). In fact, formal and informal mechanisms are complementary rather than substitute, so both mechanisms exist within the organisation. Whilst formal mechanism plays a role in hierarchical accountability (Dixon, Ritchie & Siwale, 2006), *informal mechanism* provides the actual giving of account beyond the formal explanation. Overall, through formal and informal mechanism, accountability is about "making the invisible visible" (Munro, 2012:5). The concepts and elements of accountability are summarised and presented in Figure 2-2.

Figure 2-2 The multifacets of accountability



Source: Author

2.2.3. Defining corporate governance

Similar to accountability, governance has different meanings for different people. “There are almost as many ideas of governance as there are researchers in the field” (Bressers & Kuks, 2003:65). The importance of governance is not exclusive to private-sector or corporate entities, but also encompasses public and social institutions (Thurnbull, 1997; OECD, 2001). As a result, ‘*corporate governance*’ and ‘*governance*’ are used interchangeably. Therefore, the proposition of a single and accepted definition of corporate governance is not an easy task.

Corporate governance has been defined in a wide range of fields from law and regulation to accounting and reporting (Nordberg, 2011) and its definitions can be classified into two dimensions: *narrow and broad*.

A *narrow* definition defines corporate governance as "the system by which companies are directed and control" (The Cadbury Committee, 1992:15). This definition originates from the separation between the investor as a principal, and the management (Huse, 2005). However, this perspective was criticised, as it identifies only the shareholders as the interest group of a corporate entity, and overlooks other parties such as employees, suppliers, customers, communities and government bodies. Hence, a *broader* definition of corporate governance was proposed. So, corporate governance refers to the supervision and control (or governing) process which is intended to ensure that the the management acts in accordance with the stakeholder's interests (Parkinson, 1995). In this sense, the role of governance provides overall direction to the enterprise through controlling and overseeing the management's actions, as well as satisfying accountability for the interest beyond the entity's boundaries (Solomon & Solomon, 2004).

Despite the fact that the concept of governance can be seen from both narrow and broad perspectives, both share the same idea that the core of governance is relationship (Thurnbull, 1997; Stoker, 1998; Ruhanen, Scott, Ritchie & Tkaczynski, 2010) among various participants.

2.2.4. Perspectives and different models of governance

The locus of governance studies occurs principally around boards, as it is the board of an organisation who "bears the ultimate responsibility for the integrity of corporation and general compliance with the law" (Low, 2006:376). A wide range of theories and models have been proposed in order to understand how boards work in various types of organisations (Thurnbull, 1997; Cornforth, 2004). Below is an abridged version of the prominent theories and models of governance.

2.2.4.1. Agency theory

Agency theory, otherwise known as ‘principal-agent theory’ or ’finance model’, assumes that the principal (the owners of the enterprise) and the agent (those who manage enterprise) engage in cooperative behaviour but they have different goals. This conflict of interests, and the difficulties the principal can experience when it seeks to confirm exactly to what the agents are doing, has been termed ‘the agency problem’. Agency theory has been offered as a way to resolve those problems by seeking the most efficient contract governing the principal-agent relationship (Eisenhardt, 1989).

From this perspective, the main role of the board is to ensure managerial compliance through controlling and monitoring the behaviour of managers (Cornforth, 2004). This theory and model has been dominant in corporate governance research (Keasey, Thompson & Wright, 1997; Thurnbull, 1997), and studies in this area have been focused on the mechanisms and rules used to align the interests of principals and their agents, through compensating directors and executives, audit committees or board structures (Young & Thyil, 2008) to name but a few.

2.2.4.2. Stewardship theory

Stewardship theory has been proposed to reform and reconceptualise the roles and responsibilities of the relationship between principal and agents, as well as to design and develop a more effective method for ensuring accountability (Dicke & Ott, 2002). As a steward, the main role of management is to protect and maximise organisational wealth (Caldwell & Karri, 2005), so they are motivated by the need to achieve high performance (Muth & Donaldson, 1998).

The relationship between the owner and management is defined as a partnership, so the function of the board is not to control management, but to work with management, to empower structure (Thurnbull, 1997). The criteria for selecting board members should be based on individuals' expertise and network in order to ensure that they are capable of adding value to an organisation's decision (Cornforth, 2004). Studies in this area focus on the effectiveness of fusion of the roles of chair and CEO in enhancing a company's performance (Donaldson & Davis, 1991).

2.2.4.3. Stakeholder theory

Stakeholder theory views organisations as a social institution (Wang & Dewhirst, 1992), thus recognises a wide range of groups or stakeholders in society other than just the owners. A stakeholder is "any group or individual who can affect, or is affected by, the achievement of corporation's purposes" (Freeman, 2010:vi). It includes shareholders, employees, suppliers, customers, financial institutions, governments, and other groups who may support or undermine the corporation. By incorporating different groups of stakeholder, the companies are expected to be more responsible toward broader social interests. The main function of the board and its members is to compromise, negotiate and balance the conflicting interests among them in order to achieve the organisation's goals (Cornforth, 2004).

Stakeholder theory has been a powerful tool used in describing how the members of a governing board perceive the different interests of constituencies, how they incorporate conflicts of interests, and how the institutions are actually managed (Wang & Dewhirst, 1992). Furthermore, mapping the various interests of stakeholders will help managers to identify which groups to whom the company should pay more attention (Mitchell, Agle & Wood, 1997).

2.2.4.4. A democratic perspective

The principal idea behind the democratic model is derived from a form of government that is ruled by people and involves some level of political equality among them (Held, 2006). The key principles of democratic practices encompass the following: an election process based on the idea of one man, one vote: representatives representing various interests; and separation between legislative institution, the elected members who establish policy, and the executive institution that implements the policy (Cornforth, 2004). From this perspective, the function of the board is to represent the interests of all its members.

Studies on democratic governance are concerned primarily with identifying the representative structure of boards in order to show the actual capacity of institutions to accommodate a wide range of interests (Guo & Musso, 2007), as well as the decision dilemma and selection criteria involved in recruiting the board, i.e. the balance between expertise or representation of local society (Iecovich, 2005; Guo, 2007).

2.2.4.5. Resource-dependency theory

Resource dependency theory provides external focus from an internal perspective, and assumes that an organisation is interdependent with its environment. As Pffefer and Salancik (Pfeffer & Salancik, 1978:39) state, "organizational activities and outcomes are accounted for by the context in which the organization is embedded". This theory emphasises that organisations depend on other organisations and actors for their own survival. Hence, this theory focuses on resources, the flow or exchange of those resources, and the effort to manage their dependency (Johnson, 1995).

The main role of boards is to diminish environmental dependence and uncertainty by establishing links between organisation and environment (Hillman, Canella & Paetzold, 2000). Pffefer and Salancik (1978) suggest that the board are vehicles for co-opting important external organizations. So, the principal function of the board is as an advisor rather than a decision-maker, as it is supposed to have the ability to provide contact, expertise and prestige to link with the organisation's environment (Haniffa & Cooke, 2002).

2.2.4.6. Managerial hegemony theory

Managerial hegemony theory views the board as *de jure*, not *de facto*, in governing the firm (Stiles, 2001). Therefore, the role the board plays is limited and being a management dominated-tool, i.e. passive, the board has no input on the decision-making process, and thus becomes the 'rubber stamp' of management decisions (Kosnik, 1987). Therefore, in this scenario, the role of the board has been reduced to that of occupying a symbolic role to provide legitimacy to management actions.

Empirical studies to support managerial hegemony theory are scant (Kosnik, 1987), and if anything, focus on identifying and explaining the ineffectiveness of the role of the boards. Lin (1996) identifies three main factors causing boards to lose their power to control management: biases during the process of nomination and selection of the board members; constraints in monitoring management; and low incentives to monitor management. The theories that underpin corporate governance, which affects the model of governance practices are summarised in Table 2-2.

Table 2-2 Summary of different theories and models of corporate governance and the roles of the board

Theory	Governance model	Role of the board
Agency theory	Compliance model	To align the interest of shareholders (principal) and management (agent)
Stewardship theory	Partnership model	To ensure the stewardship of the company's assets
Stakeholder theory	Stakeholder model	To represent the interests of a wide range of stakeholders
Democratic perspective	Democratic model	To represent the interests of members
Resource dependency theory	Co-optation model	To provide a link with the environment in order to diminish dependency and uncertainty
Managerial hegemony theory	'A rubber stamp' model	To provide legitimacy to management decisions

Source: Author

The different theory and governance model which is applicable in the different types of governance has impacted to the different roles of the board. However, those theories and governance models seem inappropriate for the subject of this study. Hence, it suggests to seek the appropriate governance models for such institution.

2.2.5. Accountability and governance mechanisms in different types of organisations

The governance mechanisms within an organisation can be identified by examining the interlinking structures, approaches and tools used by them (Almquist, Grossi, Helden & Reichard, 2013). In this sense, structure helps us to clarify the responsibilities of various stakeholders in relation to the organisation. The approaches adopted and the tools implemented by the board are employed to foster the management's capabilities to fulfil those responsibilities, and to ensure internal control and discharge of accountability to the stakeholders.

On the other hand, accountability mechanisms can be found in formal forms, such as in financial statements and performance evaluations, or in informal forms, such as in organisational culture, values, beliefs and communication (Boland & Schultze, 2012). Financial reports provide key information regarding economic resources, which is useful when it comes to decision-making. Therefore, financial reports play the role of communicating firm performance and governance to external users. Since the core of accountability is communicating information, financial reporting and disclosure is considered to be the primary document needed to discharge accountability to stakeholders (Connolly & Hyndman, 2004).

Performance evaluation is also deemed to be an accountability mechanism, as it enables managers to monitor, control and improve corporate performance (Lin, Chen, Tsai & Tseng, 2014). Traditionally, evaluating a company's performance could be approached using accounting data through three styles: profit-conscious, budget-constrained and non-accounting (Hopwood, 1972). The profit-conscious style evaluates performance based on an individual's ability to contribute towards company profit, while the budget-constrained style is based on the capability of an individual to continually meet budgets, and the non-accounting style is based purely on an evaluation of supervision. Recent literature provides a complex method to evaluate company's performance, not only from a financial aspect, but also non-financial aspects (Lin, Chen, Tsai & Tseng, 2014).

Accountability and governance mechanisms are also context-specific; ownership structures influence the system of accountability and governance in place. Hence, this section discusses how accountability and governance mechanisms are practised differently in for profit organisations (FPOs), non-profit organisations (NPOs) and social enterprises (SEs).

2.2.5.1. For profit organisation (FPO)

An FPO, or 'private sector' organisation, is a business organisation that is fully owned by private individuals with the aim of generating profit and is being operated by private management without government interference in terms of ownership (Lienert, 2007).

2.2.5.1.1. Accountability practices

In the for-profit sector, accountability concerns itself more with owners and shareholders, as principals, who have the right to call managers, as agents, to account for the company's performance (Mulgan, 2000a). This is because the legal system is also primarily concerned with regulating the behaviour of the private sector in order to protect the interests of the principal. Accountability and reporting practices are restricted to specific statutes (such as Company Acts), financial reporting standards and market regulation (Elliot & Elliot, 2008). Moreover, the financial reports of the for-profit sector are subject to independent audit (Torres & Pina, 2003). Empirical evidence demonstrates that the quality of financial reporting is forced by various factors simultaneously: accounting standards, audit quality, regulation and ownership structure (Holthausen, 2009). Therefore, the private sector is deemed to be more accountable in terms of its ‘bottom line’ (Mulgan, 2000b).

Traditionally, the main purpose of financial reporting is to fulfil the stewardship role of managers and to demonstrate their capability in managing corporate assets responsibly (Walker, 2006). In order to enhance decision usefulness, there is a demand for firms to disclose information that relates to financial statements such as footnotes and notes to the accounts, management discussion and analysis, management forecasts and other reports (Healy & Palepu, 2001). In its development, there is also pressure for companies to disclose social- and environmental-impact information, including energy, fair business practice, community involvement and products (Cowen, Ferreri & Parker, 1987), as an attempt to demonstrate accountability to society (Tilt, 1994).

2.2.5.1.2. Governance practices

The origin of the issue of governance emerged from the corporate failures that occurred in recent decades due to the separation between owners and the management. Hence, it became necessary to protect the interests of investors and restore public confidence in corporate and capital markets by improving the accountability of the boards (Cadbury, 1999) and empowering management to act autonomously for the benefit of shareholders (Donaldson & Davis, 1991). This governance approach that views management as a steward and is interested in achieving high performance is called the ‘stewardship model of governance’ (Muth & Donaldson, 1998).

The assumption of the stewardship model is that the boards play a crucial role not only in heightening control and strictly monitoring management, but also in empowering executives to act for the interest of an organisation’s shareholders. Hence, in order to strengthen the functions of the board, there has been the establishment of regulatory reforms to deregulate company law, as well as the introduction of listed companies, accounting standards, auditors and the stock exchange (Tricker, 2009a). In the UK, a series of codes have been produced as a guideline for best-practice of governance as a result of the Cadbury Report (1992), the Greenbury Report (1995), the Hampel Report (1998), the Turnbull Report (1999; 2005), the Higgs Report (2003) and the UK Combined Code (2003, 2006, 2008, 2012). Other countries’ experience of company collapse have followed this trajectory, and they have also issued similar corporate governance codes, such as the Himmer Report in Australia in 1993 (Plessis, Hargovan & Bagaric, 2011), and the Sarbanes-Oxley Act in the US in 2002.

2.2.5.2. Non-profit organisations (NPOs)

An NPO is an entity that is self-governing and non profit-distributing, with the dominant purpose being altruism, charity and for public benefit (Dellaportas, Langton & West, 2012). It does not, however, mean that NPOs are not able to generate profit, but rather that any surplus funds do not get distributed among organisational funders or donors. NPOs instead use these funds to pursue the organisation's principal goals (Connoly & Kelly, 2011). Some scholars refer to this kind of organisation as belonging to the '*third sector*', '*voluntary sector*' or '*civil society*', and constitutes diverse groups such as charities, NGOs and private foundations (Salamon & Anheir, 1992).

2.2.5.2.1. Accountability practices

The roles of NPOs in providing public services, such as empowering grass-root economics, protecting environmental degradation and promoting human rights, which were formerly left by the state (Salamon, 1994), have increased over the years. NPOs are incredibly diverse in scope and scale. As a consequence, public expectations towards the transparency, accountability and governance of these organisations' operations continues to grow (Hyndman & McDonnel, 2009), particularly in the case of those that receive public funding (Taylor, 1996). Moreover, accountability within NPOs has gained public attention due to publicised scandals that undermine public trust towards NPOs (Gibelman & Gelman, 2001), as well as their poor public reporting (Eisenberg, 2000).

Accountability practice within NPOs is highly influenced by a democratic perspective (Cornforth & Edwards, 1999), in which the main principle is open election based on a one-man-one-vote rule, which means that the organisation's representatives should therefore by nature represent a wide variety of interests. As a consequence, NPOs face competing demands of accountability, as they are accountable to multiple stakeholders: patrons, customers/clients and themselves (Najam, 1996). Accountability to patrons refers to discharging of accountability that focuses on the utilisation of resources to donors, funding agencies or government, i.e. upward accountability (Edwards & Hulme, 1995). Accountability to customers/clients focuses on the relationship between groups to whom NPOs provide a service, i.e. downward accountability (Edwards & Hulme, 1995). Accountability to themselves, on the other hand, refers to accountability in achieving the NPOs' mission and goals.

Theoretically, NPOs can use several mechanisms in discharging accountability to their stakeholders: financial reporting and disclosure, performance assessment, participation, self-regulation and social audit (Ebrahim, 2003a). However, practically all NPOs use financial reporting with detailed information about finance, organisational structure and programs. This aims to ensure that an NPO is eligible for tax exemption, as its activities are concerned with education, charity, and/or religion, rather than profit. Besides formal mechanisms, informal accountability such as rules, norms, trust (Romzek, LeRoux & Blackmar, 2009), storytelling (Chen, 2013) or personal relationships (Dixon, Ritchie & Siwale, 2006), are also deemed effective mechanisms in communicating and delivering information to stakeholders in an NPO context.

2.2.5.2.1. Governance practices

The imperative role of governance in NPOs has been recognised as helping to both improve organisational efficiency and meet the expectations of stakeholders. However, the governance model of FPOs is inappropriate for NPOs, as it assumes that the objective of the organisation is merely profit maximisation. This assumption is not applicable for NPOs, as the main characteristic of such institutions is that they are not allowed to distribute any profits (Enjolras, 2008). The profit they generate should be returned to the organisation for its intended purpose. Since the nature of an

NPO is that it is philanthropic, the aims of governance for NPOs therefore assure the effective use of resources, promoting the achievement of organisational objectives (Speckbacher, 2008) and ensuring services are distributed to the right beneficiaries (Hyndman & McDonnel, 2009).

In general, NPOs are established and owned by a community, rather than shareholders. So, the stakeholders of this kind of institution can widely vary, which can in turn cause the decision-making process to be a costly one (Speckbacher, 2008). For this reason, the appropriate model of governance for NPOs is democratic governance (Low, 2006). The heart of democratic governance is that all people from different backgrounds ideally have equal opportunities to voice their ideas. This is because the legal ownership of this kind of institution is shared equally among relevant stakeholders (Turnbull, 1994). As well as governance practice in FPOs, directing NPOs can be achieved through internal and external mechanisms. However, scholars in the field of NPOs' governance conclude that external mechanisms of governance, such as external auditors, accounting rules and government regulation (Hyndman & McDonnel, 2009), are ineffective for controlling their operations (Cruz & Romero-Merino, 2006). Therefore, research in this area is far more concerned with the internal mechanisms of governance, which focus mainly on the structure, composition, function, roles and power of the board of trustees.

2.2.5.3. Social enterprises (SEs)

SE is defined as "a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners" (UK Department of Trade and Industry, 2002). The emergence of SEs is driven by NPOs' quest for financial sustainability, due to the decline in support and grants from donors (Alter, 2007).

SEs differ from NPOs in that they operate like businesses, engaging in trading, competing with the for-profit sector, and taking risks in order to achieve financial self-sufficiency. Some argues that the SEs should be categorised as NPOs, but others argue that they are new hybrid organisations (Dart, 2004; Cornforth, 2011), as they pursue both social and commercial goals and operate across and between the boundaries of FPOs and NPOs. A typology of SEs in the UK includes a wide range of organisations, including co-operatives, credit unions, trading charities, community businesses, social firms and housing associations (Spear, Conforth & Aiken, 2009).

2.2.5.3.1. Accountability practices

From the accountability perspective, the main issue around SEs is the notion of the double bottom line, as any SE organisation bears both economic and social accountability (Cornelius, Todres, Janjuha-Jivraj, Woods & Wallace, 2008). As a new hybrid institution, an SE is likely to simultaneously straddle the boundary between FPOs and NPOs, thus blurring that boundary (Dart, 2004). Therefore, some scholars argue that the accountability frameworks within both FPOs and NPOs are applicable to SEs.

However, Connolly and Kelly (2011) propose an accountability framework for SEs that unveils the distinctiveness of SEs from organisations in other sectors. They argue that SEs should be accountable for three areas: legal, constructive and voluntary.

Legal accountability is intended to fulfil an SE's legal obligation to achieve its mission, thus ensuring funds are utilised properly in order to avoid malfeasance and prevent maladministration. It is implemented through establishing an appropriate structure for internal control and complying with regulatory annual reports and financial statements. Therefore, legal accountability is deemed to be primarily upward, i.e. to funders, donors, and government or oversight agencies.

Constructive accountability is concerned with performance measurement in order to evaluate whether organisational performance meets the required standards. Measuring the performance of SEs is problematic, as establishing quantifiable and objective standards to measure social impacts is not an easy task. Mechanisms to discharge constructive accountability can be created by providing performance and assessment reports, such as a balance scorecard or based on social return on investment.

Voluntary accountability is a proactive form of accountability, which is driven by moral rather than legal obligation. It is primarily intended to promote *downward accountability* to beneficiaries and the public with the aim of seeking standards of acceptable practices. It involves continuing improvement through training and organisational learning.

Given the nature of the SEs, it is argued that it is unlikely that a single set of accountability model is appropriate for such institutions. SEs might discharge their accountability through legal, constructive and voluntary accountability. However, in practice, there is a propensity to overemphasise traditional financial account in discharging accountability and overlooking performance information (Connolly & Hyndman, 2004).

2.2.5.3.1. Governance practices

SEs may have multiple identities due to the blurring of boundaries that naturally occurs in their operations between the social and commercial sectors (Spear, Conforth & Aiken, 2009); however, an SE can operate as a charity, which brings it towards being more like an NPO, or it can be run as a trade union, which makes it more like an FPO.

The consequence of these chameleon forms of the SE makes determining an appropriate model of governance for SEs to be somewhat tricky. Some argue that communitarian governance is the best model for SE (Ridley-Duff, 2010). Communitarian views the organisation as a separate entity and independently doing good and harm (Fogarty, 1998). This implies that corporate managers should be responsible not only to the shareholders, but also to all the corporate stakeholders (Bradley, Schipani, Sundaram & Walsh, 1999). However, this model raises a question about how a firm's value should be allocated equally to various stakeholders. Alternatively, democratic governance, which has been discussed in previous sections, has been proposed to tackle this issue, because SEs tend to be classified as being NPOs (Low, 2006).

The observation of governance practices in different places has led to varying results. Selected employee-owned companies in the UK employ communitarian governance (Ridley-Duff, 2010) whereby all the company members understand their rights and responsibilities. Therefore, this enables them to fully participate in the governing process, and have a hand in developing the norms of governance within the company. Another study examining 38 SEs in China confirms that they each adopt different forms of governance (i.e. government-supervised, member-regulated and shareholder-control), depending on the ownership pattern (Yu, 2013). However, due to the hybridisation of the ownership structure and governance models among SEs in China, this practice could not be fully explained by the existing dominant theories of governance that have been developed in Western countries. The practice of accountability and governance in different organisations is summarised in Table 2-3.

Table 2-3 Accountability and governance practices in different types of organisations

Mechanism	FPOs	NPOs	SEs
Accountability practice	Focus on communicating information to stakeholders through: - Financial reporting - Disclosure - Social- and environmental-impact information	Focus on providing *holistic accountability* to provide information to wider stakeholders – patrons (*upward*), clients (*downward*) and themselves (*lateral*) – through formal and informal mechanisms: - Financial reporting and disclosure - Performance assessment - Participation - Self-regulation - Social audit - Rules, norms, trust - Informal communication	Focus on realigning accountability arrangements to minimise tensions between profit and social goals. The discharge of accountability can be carried out through fulfilling: - *Legal accountability* (financial reporting and disclosure) - *Constructive accountability* (performance assessment) - *Voluntary accountability* (continuous improvement through training and organisational learning)
Governance practice	Focus on reducing fraud within management through: *Internal mechanisms*: - Ownership structure - Executive compensation - CEO-chairman duality - Audit committee *External mechanisms*: - Threat of takeover - Market competition - Managerial labour	Focus on ensuring the effectiveness of resource utilisation, promoting the achievement of organisational goals, and ensuring the service is distributed to the right beneficiaries. Governance practice conducted mainly through *internal mechanisms*: structure, composition, function, role and power of the board of trustees	Focus of governance depends on the individual characteristics of each institution. If the organisation is concerned with attracting investment, then the *stewardship governance model* is applicable, and the role of the board is to ensure the effectiveness of asset utilisation If the institution is owned by the community, then the *democratic governance model* is appropriate for accommodating the interests of various groups. Hence, the role of the board is to represent different interests rather than to manage the company's assets

Source: Author

The different practices of accountability and governance in different types of organisations implies that governance and accountability practice is dynamic (Overall, Tapsell & Woods, 2010). As Tricker (2009b) argues, the theories that underpin corporate governance are ethnocentric, being that all the ideas that comprise it are derived from a Western perspective, which upholds the respective roles of individuals, institutions and the state, and the relationships between each of them. This suggests that, for this study, there is a need to seek out models of accountability and governance that is derived from non-Western perspective, i.e. an Islamic perspective. Therefore, the next section discusses the Islamic paradigm that underpins accountability and governance from an Islamic perspective.

2.3. Understanding the *Shari'ah Islamiyah* paradigm

The Arabic word *shari'ah* or *sharia* literally means "the way to the source of life" (Algaoud & Lewis, 2007), and in common usage, it means the prohibition, command, guidance and principles from Allah [4] to mankind concerning their conduct, both in the world and salvation in hereafter (Kamali, 1989). The word *shari'ah* is stated in the *Quran* :

> *"Thus We gave you a shari'ah (a path to be followed) in religion, so follow it and follow not the wishes of those who have no knowledge"* (the Quran, *Al-Djaasi'jah. 45:18).*

Hence, *shari'ah* can be seen as the epitome, core and kernel of Islamic thought, and it thus manifests itself as the Islamic way of life. *Shari'ah* is conterminous with Islam itself, so it can be isolated from the values, objectives and basic beliefs of Islam. For this reason, the term *shari'ah* was fused to *Islami'iah* to form *shari'ah Islami'iah,* which is defined as "a very broad concept comprising the divine law governing the

[4] Although the English translation God has often been used to denote Allah, from the linguistic perspective it is incorrect. Hence, the word Allah will be used in this thesis instead of God.

life of individual, human beings as well as all other being" (Zaid, 2004:154). Within the *Shari'ah Islamiyah* paradigm, the episteme stems from the Unity of Allah or *Tawhid*. This term encompasses five concepts of unity: Allah, truth, creation, humanity and life (Safi, 1993). Essentially, the concept of unity depicts the two sides of a coin. One face implies that Allah is the creator of the universe, as the *Quran* states:

> *"He it is Who created for you all that is in the earth" (The Quran. Al-Baqarah. 2:29).*

The other side implies the relationship between fellow humans – that they are brothers and sisters in equality (Rice, 1999). The conception of the Oneness of Allah is not restricted by material bounds of space or time, as the *Quran* has constructed historical process through a narrative that leaves permanent and perennial morals for the purpose of providing guidance to humankind. Moreover, the fundamental belief that Allah is pure, complete, perfect and full of knowledge, has been inculcated from the primordial beginning (Choudhury, 2007). Therefore, the principles of unity within the Islamic paradigm "belong to the theory of being/ontology and hence form of ontological presuppositions of an Islamic theory of knowledge/epistemology" (Safi, 1993:25).

There are four sources of the *Shari'ah Islami'iah* paradigm (Haniffa & Hudaib, 2002). The primary source is derived from the *Quran* (the words of Allah) and the *Hadith* (the words, life, practice, behaviour and actions of the Prophet Muhammad, Peace be Upon Him (PBUH), during his lifetime which are memorised and written down by his followers). The third source of *shari'ah* is *ijma* (consensus or general agreement) among Muslim scholars on a particular issue. *Ijma* can only be applied when explicit reference to such issues cannot be found in the *Quran* and *Hadith*; the agreement reached through *ijma* should be consistent with both the *Quran* and *Hadith*. The final source is *qiyas* (analogical reasoning), which refers to the process of deduction regarding contemporary issues, based on an analogy of a practice that existed in the past. Recourse of *qiyas* can be only justified in the absence of explicit solutions from a more authoritative resource – the *Quran*, the *Hadith* and the *ijma*. Despite the fact that *ijma* and *qiyas* hold the most risky for change, when the decision to specify *ijma* or *qiyas* has been made, the decision becomes mandatory and cannot be abolished by future generations (Zaid, 2004).

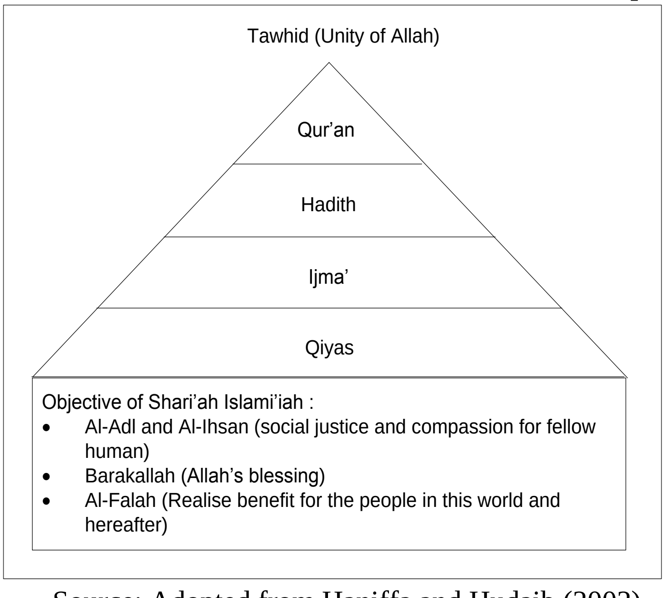
In the context of economy and business, the main objective of *Shari'ah Islami'iah* is to safeguard humankind's interest in this world and the hereafter (Kamali, 1989), and to promote a person's welfare by safeguarding their life, their faith, their prosperity, their intellect as well as their wealth (Haniffa & Hudaib, 2002). The objectives can be attained by promoting economic justice (*al-adl*) and social welfare (*al-ihsan*) and to seek Allah's blessing (*barakallah*). By adhering to *sharia'ah*, mankind can achieve *al falah* (the ultimate quality of life) and *maslahah* (wellbeing, and benefit to other people) (Haniffa & Hudaib, 2002; Azis & Noh, 2013).

The literal meaning of *adl* is "placing things in their right place where they belong" Kamali (1989:226). The concept of *adl* can be seen as an effort to establish equilibrium within society by eradicating disparity and excess in all aspects of life. In the context of business, Islam emphasises that the goals of Islamic economics and business are not primarily materialistic. A Muslim is not someone who focuses only on the maximisation of utilisation (Arif, 1985). Instead, the goal of Islam is to eliminate all forms of exploitation, inequality and oppression (Rice, 1999). Therefore, Islam strictly prohibits any form of *riba* (usury or interest), *mayseer* (gambling) or *gharar* (uncertainty) for the reason of avoiding exploitative, unfair practices and/or inequality (Warde, 2000). If *al-adl* is a legal concept, *al-ihsan* is a moral concept and it literally means benevolence, magnanimity, proficiency, and fineness in dealing with other people, or in short, it is defined as doing good to other people (Amer & Yahya, 2014). The concepts of *al-adl* and *al-ihsan* are found together in the *Quran*:

> "*Surely Allah orders justice and good conduct (ihsan) to others" (The Quran. An-Nahl. 16:90).*

It implies that justice should be attempted in the spirit of *ihsan*, in equity and in good faith in order to gain the pleasure of God (*barakallah*). Hence, following *shari'ah Islami'ah* will guide mankind to achieve the ultimate objective of *shari'ah* or *maqasid shari'ah* (*maqasid* is the plural of *maqsad*, meaning 'objective'), *viz* – to preserve and protect public interest *(maslahah)* in all aspects of life, and to achieve human welfare everywhere in the world and the hereafter (*al-falah)* (Haniffa & Hudaib, 2002; Azis & Noh, 2013). The principle and basis of the *shari'ah Islami'iah* paradigm is illustrated in Figure 2-3.

Figure 2-3 The foundation of the *Shari'ah Islami'iah* paradigm



Source: Adopted from Haniffa and Hudaib (2002)

The concept of accountability and governance from an Islamic perspective will be elaborated on in the next section.

2.4. Understanding accountability and governance from an Islamic perspective: definition, concept and mechanism

Islam is a way of life, and it commands authority over all aspects of Muslim life and does not accept the separation between the sacred and secular. Hence, economics, business, politics, religion, ethics and society all fall under the jurisdiction of *shari'ah*. Moreover, Islam has formulated how business should be conducted, organised and governed, including how financial reports should be prepared as part of accountability to Allah and the community (Lewis, 2006).

Compared to Western concepts, Islamic accountability and governance has unique features and distinctive characteristics (Hasan, 2009). This is because the main characteristic of Islamic business is grounded on the ethical and moral framework of *shari'ah* (Abu-Tapanjeh, 2009) to provide fair, honest and social commitment to balance society (Hasan, 2009). Therefore, all forms of economic exploitation is strictly prohibited and ultimately accountability and governance from an Islamic perspective combines the element of *Tawhid*, *Shura* and *Shari'ah* rules (Hasan, 2009).

2.4.1. Defining accountability

Accountability has been ordered in many scriptures (Barlev, 2006; Ogunewu & Adesegun, 2011), including in the *Quran* that inscribed the word of *hesab* – meaning 'to account' – more than eight times (Lewis, 2006). This indicates that accountability is one of the central themes in Islamic teaching. Other Arabic words that correspond to the concept of accountability are *takleef* (legal obligation), *muhasabah* (self-accountability) and *mas'uliyyah* (responsibility and accountability based on certain duties and position). *Takleef* refers to the obligation that is imposed by certain conditions, *viz* biological age of puberty, pubescent and sane, so that an individual is capable of conducting their duties and responsibilities (Abubakar, 2012; Malik, 2013). *Muhasabah* relates to the idea of self-evaluation in preparation for accepting greater responsibility (Weir, 2012), while *mas'uliyyah* encompasses the concepts of both accountability and responsibility (Mohamad, 2002; Haniffa & Hudaib, 2010).

Islamic views on accountability take a rather comprehensive approach. In order to comprehend the holistic concept of accountability from an Islamic perspective, it is necessary to understand the two related concepts that is derived from *Tawhid:*

a. The concept of vicegerent (*khalifa*):

   Human beings are considered to be *khalifa* or vicegerents of Allah on earth, with their main duty being to protect Allah's creations, as the *Quran* states:

   > *"…when Allah said to the angels, 'Indeed, I will create a vicegerent on earth...'" (The Quran. Al-Baqarah. 2:30).*

b. The concept of ownership:

   While Allah is the creator and supreme owner of everything, He entrusted all the natural resources to His vicegerent on earth with the stewardship of all His possessions. Therefore, ownership in Islam is perceived as a trust (*amanah*), which should be utilised in accordance to *shari'ah* principles (Lewis, 2006).

In short, since human beings act purely as the *khalifa* on earth to safeguard Allah's possessions, every Muslim consequently has an obligation to account to Allah for all things pertaining to human endeavour. Moreover, the belief in the hereafter and the Day of Judgment, which is one of the six pillars of the Islamic faith, also underpins the concept of accountability from an Islamic perspective. Muslims believe that besides the present life, there is another eternal life after death that begins when the universe is destroyed. They believe that they will be resurrected for judgment, and will have to account for their actions to Allah.

> *"Allah takes careful account all things" (The Quran. An-Nisa. 4:86).*

Allah records all actions, thoughts and feelings of each human during their lives through two angels – one seated on the right, to record good deeds, and one seated on the left, to record bad deeds.

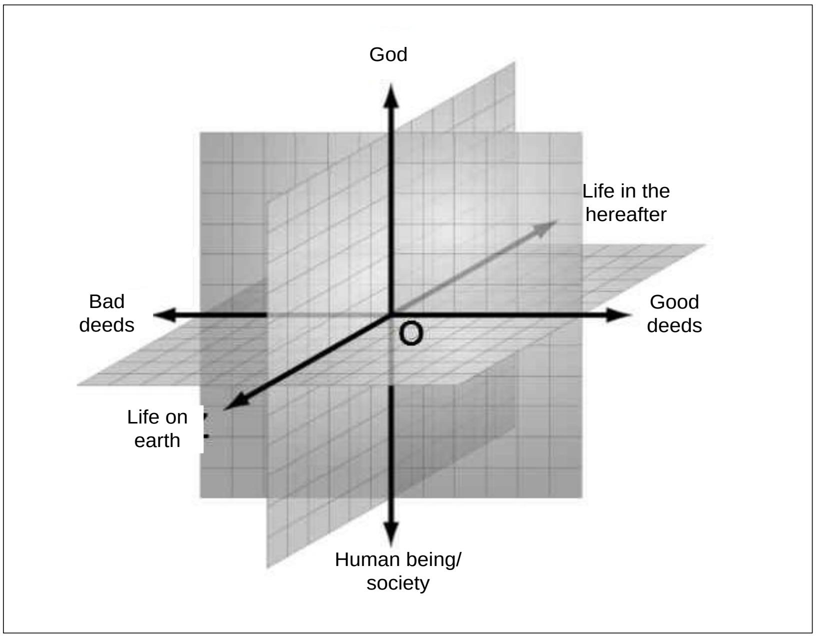
> *"Man does not utter any word except that with him is an observer prepares [to record]" (The Quran. Qaaf. 50:17).*

The angels accumulate the records and it will be presented to each person on the Day of Judgment, as the day of final accountability. Hence, accountability means that "everyone is accountable for his actions and inactions on the Day of Judgment" (Abdul-Rahman, 1998:62).

Driven by those beliefs, therefore, the accountability seen from an Islamic perspective in an IMFI goes beyond that seen from the actors in its conventional counterpart. It encompasses accountabilities for three dimensions: to other human beings and ultimately to Allah in the hereafter, for the good and bad deeds carried out during a person's life on earth, as illustrated in Figure 2-4

Figure 2-4

Figure 2-4 Three dimensions of the concept of accountability from an Islamic perspective



Source: Author

2.4.2. The elements of accountability

This section explains four imperative accountability questions as suggested by Bovens (2007a): who is accountable, to whom is account to be rendered, what is accountability made for, and how is accountability practised, from an Islamic perspective.

2.4.2.1. Who is to be accountable

From an Islamic perspective, ‘who is accountable’ is derived from the concept of the vicegerent. Allah created mankind to be His servants and His vicegerents (*khalifa*), which means representatives or trustees of Allah on earth (Noordin, 2013). In ethical terms, *khalifa* denotes that humans were created as moral agents, so there is no distinction between females and males in term of divine mandate (Wadud, 2008). Human beings are mandated with the main accountability to worship.

> *"And I did not create the jinn and mankind except to worship Me"*
> *(The Quran. Az-Zaari'jaat. 51:56).*

Worship of Allah is much more comprehensive and not merely formalism – the concept of worship is all-inclusive. "Any act is potential act of worship if it is done with pure intention and within the limits prescribed by Allah" (Beekun & Badawi, 2005:133). Since life on earth is considered to be a test of mankind (67:2), each human is therefore free to choose how he or she behaves. However, each of them is accountable for their actions, both individually and collectively.

2.4.2.2. To whom is account to be rendered

The concept of *Tawhid* that underpins the accountability question of "to whom is account to be rendered?" has been discussed in section 2.4. *Tawhid,* which literally means belief in Allah, the Only and One God who is the Creator, the source of knowledge and guide (Barazangi, 1996). The concept of *tawhid* formulates the spirit relationship between human beings and Allah (*hablun min* Allah), to whom there is direct access, with His creatures and other human beings (*hablun min al-nas*) (McKechnie, Grant, Tucker & Kuehn, 2007).

Besides making human beings his *khalifah*, Allah created them as His servants (*'abd*) with the main purpose of serving Him with responsibilities and accountabilities, therefore making human beings different from other creatures (Othman, 2011). As Allah's servants, mankind is required to truly submit to Him and devote themselves entirely to His commandments (Ismail & Sarif, 2011). Based on this belief, human beings are therefore ultimately accountable to Allah

> *"To Allah belongs whatever is in the heavens and whatever is in the earth. Whether you show what is within yourself or conceal it,*

> *Allah will bring you to account for it...” (The Quran. Al-Baqarah. 2:284).*

This belief becomes an imperative constraint for individuals in any decision-making and subsequent actions, being that all ideas and actions should be consistent with the will of Allah (McKechnie, Grant, Tucker & Kuehn, 2007).

2.4.2.3. What is accountability for

The combined concepts *of khalifah, tawhid* and ownership are relevant to explaining the question of “what is accountability for?” While the concept of *tawhid* defines the relationship and accountability of man as a *khalifah* and an *‘abd* with Allah, His men and His creatures; the concept of ownership in Islam limits boundless private ownership.

As an ‘*abd*, the main accountability of human beings is to fulfil obligations and duties to Allah (*haqu-qu-Allah*), or *vertical accountability*, in the form of prescribed ritual worship (*ibadah*). As a *khalifah*, human beings have an obligation and duty to society and His creatures (*haqu-qul-ibad*), or *horizontal accountability*, to promote wellbeing (Chapra, 1992; Haniffa & Hudaib, 2002) in the form of all human interactions in worldly matters (*muamalah*) (Putrie, 2010). Humans are accountable both as individuals and collectively as a society. As individuals, human beings are accountable for fulfilling the obligations of the contractual deal, or *uqud*.

> *“O you who have believed, fulfil [all] contracts...”(The Quran. Al-Maidah. 5:1).*

Uqud encompasses various aspects of life: marriage contracts, business agreements, and political treaties (Mohammed, 1988). As a member of a community, humans are accountable to society (*ummah*). This is because all resources in the universe belong to Allah, and human beings are responsible for managing these resources for the benefit of the *ummah* (Muhamad & Muwazir, 2008). Moreover, the concept of brotherhood, i.e. that all believers are brothers, obliges people to be responsible for and help each other (Kaleem & Ahmed, 2010).

At the end, each individual is accountable for all their actions in this world, both past and present (Chapra, 1992). Therefore, Haniffa and Hudaib (2002) suggest another dimension of accountability: that human beings also have an obligation to account to themselves (*huqu-qu-shakhseea*) (*lateral accountability*) in order to achieve *al-falah.* This is a kind of self-retrospection to evaluate what they have done as well as to assess their actions/

> *"... and let every soul look to what it has put forth for tomorrow – and fear Allah. Indeed Allah is Acquainted with what you do" (The Quran. Al-Hasjr. 59:18).*

2.4.2.4. How is accountability practiced

Within the context of business, an accounting system is intended to discharge accountability. From an Islamic perspective, the function of accounting is not limited to providing financial information to the users – rather, it also enables users to make economic and religious decisions (Haniffa, Hudaib & Mirza, 2005). Hence, Islam has provided the guidelines for recording transactions and preparing financial reports and disclosures (Lewis, 2006). In terms of recording transactions, Islam demands that people keep a record of their debts in order to remove any uncertainty or doubt from interpersonal engagement, as mentioned in the *Qu'ran*:

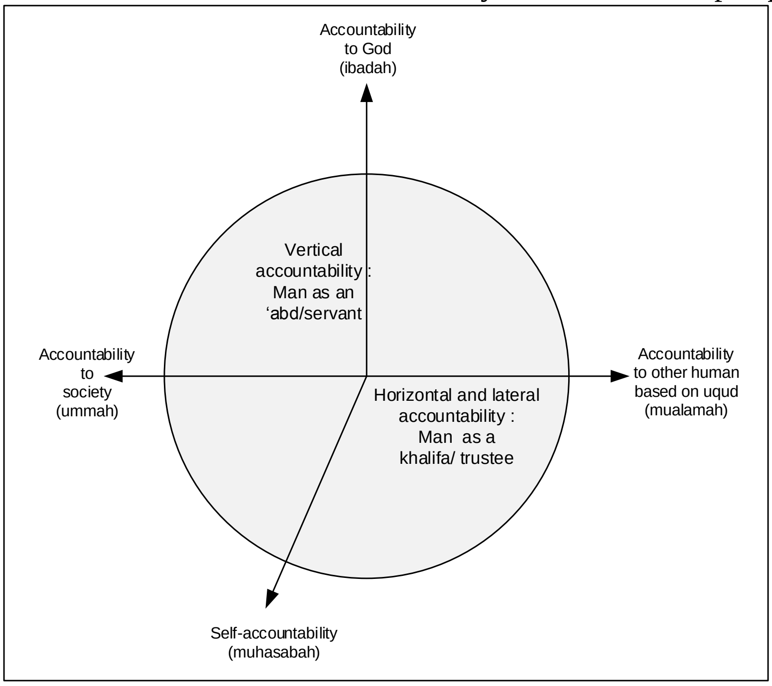
> *"Believers, when you contract a debt for a specified term, write it down. And let a scribe write [it] between you in justice [...] and let the one who has the obligation dictate, not diminishing the sum he owes..." (The Quran. Al Baqarah. 2:282).*

Further, this verse advises that the debtor should sign to acknowledge the transaction, as a form of verification (Lewis, 2001).

For preparing financial reports and disclosures, several verses of the *Quran* provide the fundamental principles: materiality, reliability, periodicity, presentation and full disclosure (Lewis, 2001). This framework is intended to accomplish a faithful obligation, as well as provide information in accordance with *shari'ah* requirements. As Gambling and Karim (1986) observe, Islamic users require financial information related to some aspects of Islamic business principles that follow *shari'ah* principles. Specifically in Islamic banks, a standard for financial reporting has been set up with the internal process to assure that the operations of Islamic banks do not breach the *shari'ah* principles (Karim, 1995). Therefore, the financial reports of Islamic banks including other Islamic financial institutions, should ideally clearly communicate the commitment to operate, to provide returns, to engage in investment, to engage in financial activities, and to fulfil contractual relationships, all based on *shari'ah* principles (Haniffa & Hudaib, 2007).

Since the roles of *zakah* and *ummah* are important in Islamic society, Gambling and Karim (1986) also suggest the use of an accounting system to provide a detailed disclosure of sources and uses of *zakah* funds, as a form of accountability to wider society. Moreover, as philosophy, the principles and criteria of Islamic business differ from those of conventional accounting systems, hence Baydoun and Willett (2000) suggest that besides the current balance sheet, Islamic entities should provide a value-added statement (VAS) rather than merely an income statement. The argument underpinning this is the ethical Islamic principle that should be portrayed in businesses' activities. The VAS is deemed to rearrange the information in the income statement, which focuses on the shares of the group rather than the owners. This is because, from an Islamic perspective, *ummah* has the right to know whether the firm operates within *shari'ah* principles, as the operation of a firm affects their wellbeing. In other words, accountability to Allah should be interpreted as providing information freely (Lewis, 2001). The dimensions of accountability from an Islamic perspective as discussed earlier are illustrated in Figure 2-5.

Figure 2-5 The dimensions of accountability from an Islamic perspective



Source: Author

2.4.3. Defining governance

Unlike the term "accountability", there is no obvious term in Arabic that represents the core of governance (Iqbal & Lewis, 2009) as several Arabic words have a close meaning to governance: *shura* (consultative), *al-hakimiyyah* (the sovereignty of Allah) and *al siyasah al-shari'ah* (management/administer). *Shura* is a process of consultative decision-making (Khan, 2002) that states in the *Quran*: "and consult with them on the matter" (The Quran. Al-Imraan. 3:159). The term *Al-hakimiyyah* is deemed to go beyond the conventional view of governance, believing that the source of all power and authority belongs to Allah (Iqbal & Lewis, 2009). *Al siyasah al-shari'ah* refers to Islamic jurisprudence related to management and administration of general matters based *on shari'ah* principles (al-Qudsy & Rahman, 2011).

The concept of corporate governance from an Islamic perspective does not differ from the conventional model (Hasan, 2009) – it refers to a system in which companies are controlled and directed. However, Islamic governance concerns broader decision-making that uses the premise of Islamic socio-scientific epistemology, which is premised on the divine oneness of Allah (Choudhury & Hoque, 2006). Therefore from an Islamic perspective, governance is essentially a decision-making process guided by Islamic moral values (Abdul-Rahman, 1998; Choudhury & Hoque, 2006; Iqbal & Lewis, 2009; Bhatti & Bhatti, 2010). Furthermore, the ultimate objective of governance is to stimulate common wellbeing, or achieving the *maqasid shari'ah*, in which social goals become strongly complemented with private goals (Choudhury & Hoque, 2006).

2.4.4. Mechanism of governance

A framework and mechanism of Islamic governance comprises four elements: *hisba* (prevention and forbidding wrongdoing), *shura* (mutual consultation), religious audit (*shari'ah* audit) and monitoring by *shari'ah* supervisory board (Abdul-Rahman, 1998; Lewis, 2005; Bhatti & Bhatti, 2010; al-Qudsy & Rahman, 2011).

The word *hisba* literally means the act of counting or the evaluation of something (Hamarneh, 1964). This term was used for the institution established during the Caliphate Umar, with the function of carrying out the commands of the Holy *Quran* in the marketplace (al-Qudsy & Rahman, 2011). *Hisba* was intended as an ethical and religious-system control.

> *"let there arise out from among you party inviting to all that is good, enjoining what is right and forbidding what is wrong..." (The Quran. Al-Imraan. 3:104).*

The *hisba* institution is headed by an officer, namely *muhtasib*, who is responsible for promoting the high morals to act against omissions, to enforce an ethical code of conduct and to establish regulation in dealing with different professions (Hamarneh, 1964). In relation to business affairs, *muhtasib* has a duty to give people a right to fair trade, check for business fraud, keep the market free, and audit illegal contracts (Abdul-Rahman, 1998). This institution played a significant role during the expansion of Islam, which was followed by an increase in business activities. It spread to North Africa during the 10^{th} Century (Hamarneh, 1964) and it still survives as an enforcer of Islamic standards of governance (Iqbal & Lewis, 2009).

The meaning of the term *shura* is "a collective endeavour for seeking an objective truth" (Khel, 1980:271). Therefore, *shura* refers to a decision-making process in which a decision was made after a problem was discussed and the member has expressed their opinions until a consensus is reached (Bhatti & Bhatti, 2010). The mutual consultation is mentioned in the *Quran* as being a praiseworthy activity:

> *"And consult them on affairs (of moment). Then, when thou has taken a decision, put thy trust in Allah" (The Quran. Al-Imraan. 3:159)*

> *"Those who listen to their Lord, and establish regular Prayer: who (conduct) their affairs by mutual consultation: who spent out of what We bestow on them for Sustenance" (The Quran. Asj-Sjura. 42:38)*

During the era of the Prophet (PBUH), and subsequent eras, the *shuratic* process plays a vital role in matters relating to state, government and political development (Khel, 1980). The reason for this process is that the decision may affect more than one person, so it is not unethical or unacceptable if one person makes a decision at the expense of other individuals. Such a decision brings great responsibility, so the consciousness that they are accountable to Allah will prevent them in making decisions without consultation (Abdul-Rahman, 1998). This is relevant to the practice of modern governance, as it promotes the participation of people, meeting their interests and upholding transparency and accountability in the process of decision making (al-Qudsy & Rahman, 2011).

Religious audit aims to supervise and to ensure the conformity of the operational firm to *shari'ah* (Islamic law) (Bhatt & Tang, 2001). The main functions of religious auditors lie in three areas: to provide advice (ex-ante auditing), to monitor performance (ex-post auditing) and to audit Islamic tax (*zakah*) (Abdul-Rahman, 1998). Ex-ante auditing represents the role of religious auditors to provide advice about religious acceptability of the enterprise's operations, contracts and procedures. Ex-post auditing is intended to provide an independent report about operational compliance with *shari'ah* principle. Furthermore, an audit of *zakah* is required to ensure that the *zakah* fund is being correctly assessed, properly administered and rightfully distributed. Therefore, a religious audit is essential in assuring the internal and external stakeholders that the company operations conform to *shari'ah* (Bhatti & Bhatti, 2010).

The *shari'ah* supervisory board is an internal control system put in place to ensure that organisational operations are in line with both the external regulations and the external audit requirements. The work of this board employs religious supervision, some of which, therefore, overlaps with the scope of the religious audit (Lewis, 2005). Hence, the board plays significant role in preserving society's trust, as most investors and clients will lose their confidence in the organisation if the management continues to infringe *shari'ah* law.

2.5. Accountability and governance: Comparison of Western and Islamic perspectives

The first section of this chapter discussed the concepts and mechanisms of accountability and governance from a conventional, or Western, perspective, and continued by explaining the concepts and mechanisms of accountability and governance from an Islamic perspective.

The main distinction between conventional and Islamic perspectives lies primarily on the philosophical foundation. While the conventional perspective is driven by a rationalism episteme, the Islamic model, in contrast, is influenced by Islamic *moralism*, which is based on the concept of *Tawhid,* or Unity of Divine Knowledge as an absolute truth. Accordingly, the objective of Western accountability and governance is to maximise shareholders' wealth, while the Islamic version views that the ultimate objective is to seek Allah's pleasure and to stimulate social wellbeing. The comparison between the dimensions of the Western and Islamic accountability and governance mechanisms, as discussed at the beginning of this chapter, is summarised as illustrated in Table 2-4.

Table 2-4 Comparison of Western and Islamic perspectives of accountability and governance

Aspects		Western	Islamic
Episteme of accountability and governance		Rationalism	*Tawhid*
Objective accountability and governance		Maximisation of profit and shareholder value	Allah's pleasure and social benefit and social wellbeing
Accountability dimension	Who is	Individual and organisation	Individual
	To whom	Primarily to shareholders and secondarily to wider community	Ultimately to Allah and secondarily to society (*ummah*)
	For what	• Legality • Procedure • Resources • Performance	All actions during life in the world are made as a servant ('*abd*) and a trustee (*khalifa*) of Allah
	Aim of accountability practice	Provide financial information for shareholders for economic decision-making	Provide information to *ummah* for economic and religious decision-making
Governance	Mechanism	*Internal:* Structure of board, ownership structure, audit committee, compensation *External:* Market labour, takeover	• *Shura* • *Hisba* • *Shari'ah* supervisory board • Religious audit

Source: Author

The different conceptions, perceptions, mechanisms and practices of accountability and governance demonstrate that accountability and governance are dynamic rather than static. There are two main reasons that cause the dynamics of accountability and governance. First, is that both accountability and governance are social and contractual relationships (Laughlin, 1990; Thurnbull, 1997; Stoker, 1998; Bovens, 2007a; Ruhanen, Scott, Ritchie & Tkaczynski, 2010) between corporations and a wide range of stakeholders. This is reflected by the question of 'to whom is account to be discharged?'

Secondly, accountability and governance involve an interactive and continuous process (Fox & Brown, 1998; Stoker, 1998; Bressers & Kuks, 2003; Fisher, 2004; Jepson, 2005). As a process, accountability constitutes a concrete practice of account-giving to explain and justify their conduct. Moreover, as a process, governance encompasses a set of mechanisms to establish decisions about conducting supervision of managerial actions, discharging accountability to stakeholders, and setting strategic actions (Rayman-Bacchus, 2003).

Due to their dynamic process and relationship, there is no single model of accountability and governance that fits all organisations. Social patterns and contextual factors matter in building accountability and governance practices (Overall, Tapsell & Woods, 2010). Hence, the practice of accountability and governance can be discovered in many ways. This supports the argument that accountability and governance is subjectively, socially and continually being constructed (Jackson & Carter, 1995; Sinclair, 1995; Thurnbull, 1997; Yakel, 2001; Abdul-Rahman & Goddard, 2003; Ebrahim, 2003b), that they are influenced by social norms, values, behaviours, beliefs, traditions and rules (Skelcher, Mathur & Smith, 2005; Rhodes, 2007).

This suggests that researchers need to seek the ways in which governance practice is constructed in different contexts (Ahrens & Khalifa, 2013), since historical and cultural context affects the establishment of accountability and governance practices (Overall, Tapsell & Woods, 2010). This study posits to follow this suggestion to understand how accountability and governance are constructed and practiced in a specific context: Indonesian Islamic Micro-finance Institutions (IIMFIs).

2.6. Summary and conclusion

This chapter has discussed the concept of accountability and governance. It began by clarifying the definition of accountability. Since accountability is an eclectic concept and can mean different things to different people, the four elements of accountability have therefore been explained in order to help offer an understanding of the nature of accountability as both a relationship and a process. The second section highlights the concept of corporate governance, and how it differs from management. The theories of governance that underpin the different perspectives and models of governance have been elucidated. This clarification is important in understanding how accountability and governance mechanisms are adopted differently in different types of organisations, namely FPOs, NPOs and SEs. This study argues that accountability and governance mechanisms are socially constructed. Therefore, the *Shari'ah Islami'iah* paradigm has been discussed in order to provide a basic understanding of global practice prior to discussing accountability and governance from an Islamic perspective.

The end of this chapter briefly discusses a comparison of accountability and governance from conventional and Islamic perspectives. Since the focus of this study is on IIMFIs, the next chapter will discuss both MFIs and IMFIs. This is followed by a literature review on accountability and governance practices particularly in different types of IMFI. It will also review studies conducted regarding this aspect in IMFIs which will enable in highlighting the research gaps.

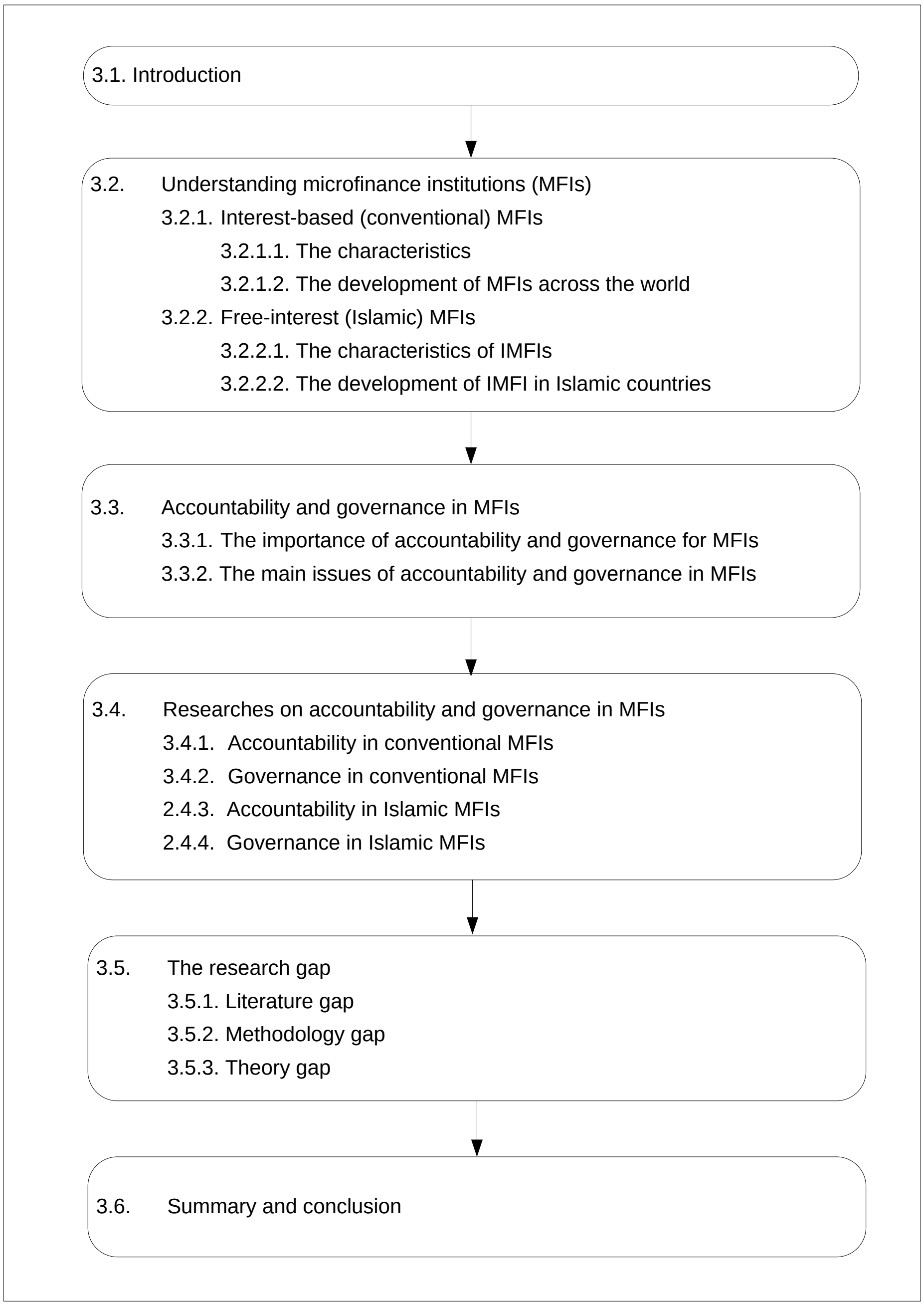
CHAPTER 3 ACCOUNTABILITY AND GOVERNANCE IN MICRO FINANCE INSTITUTIONS

3.1. Introduction

The previous chapter discussed the concepts and mechanisms of accountability and governance in different types of organisation. This chapter presents a review of the relevant literature on the practice of accountability and governance in a specific context: MFIs. Literatures suggest that accountability and governance are becoming effective tools in improving their performance and helping their continuous efforts to serve lower-income demographics in the long term (Vogel & Llianto, 2006; Kyereboah-Coleman & Osei, 2008; Rural Finance Network, 2008; Kansiime, 2009; Aboagye & Otieku, 2010).

This chapter begins with an overview of MFIs, with, the first part discussing interest-based MFIs, and the second part interest-free MFIs. The MFI sector evolved from being an informal one to being a more formalised one by later developing into various types of institution, such as commercial banks, NGOs, savings and credit cooperatives, and credit unions (Greuning, Gallardo & Randhawa, 1998; Meyer & Nagarajan, 2006). Hence, the next section follows the template from the previous chapter in presenting the accountability and governance practices that occur in different types of MFI. This chapter is summarised with a presentation of the literature gaps in this area, which forms the motivation of this study. The structure of Chapter 3 is illustrated in the Figure 3-1.

Figure 3-1 The structure of chapter 3



3.2. Understanding microfinance institutions (MFIs)

From the onset, the term microfinance was used to define a financial intermediation between micro savers, micro borrowers and micro investors (Seibel, 2005a). This definition is now far more comprehensive. An MFI is defined as being a financial institution that provides a wide range of products and services, from savings to loans, insurance, remittances and payments, all on a small scale to help low-income groups in society who are excluded from using commercial banks to access such products and services (Dowla & Alamgir, 2003; Armendáriz & Murdoch, 2010). Sometimes, the terms "microfinance" and "microcredit" are used interchangeably (Cornford, 2001). In general, there are two types of MFI: conventional (interest-based) and Islamic (interest-free).

3.2.1. Interest-based (conventional) MFIs

3.2.1.1. The characteristics

There are a number of characteristics of the conventional MFI. First, it provides financial services on a small scale. In most cases, the loan structures offered by an MFI require that the repayments be made on weekly basis within a short time period to prevent a high rate of delinquency. There is no general consensus in determining the threshold for the classification of the size of the loan, due to the variability of MFIs' funding, as well as the diverse exchange rate across the country. However, in a broad sense, any loan of less than USD$100 is categorised as a small loan (Aubuchon & Sengupta, 2008).

Secondly, MFIs are devoted to serving those in society who live below either the minimum level of consumption or the poverty line (Ruit & May, 2009). Although the World Bank has established an international poverty line, namely households living below USD$1, the threshold is not applicable for all countries, due to the variation in the methods for measuring poverty levels (Hagenaars & Vos, 1988).

Thirdly, MFIs do not require collateral, which tends to be a condition of most banks' operation as a sort of insurance against the debtor defaulting. Since those with lower incomes tend not to be able to provide collateral (Cull, Dermigüç-Kunt & Murdoch, 2009), this group is overlooked by the commercial banks. However, in the attempt to accommodate their needs for credit, many MFIs apply joint-liability lending (Karlan & Goldberg, 2011), whereby a group of people provide peer-group support and share the responsibility to repay the loan.

3.2.1.2. The development of MFIs across the world

The concept of microfinance does, in fact, have a long history. It is now widespread in many countries and manifested in an informal form (Seibel, 2005a). Formalisation of the MFI first occurred in Ireland at the beginning of 1700 (CGAP, 2009), with similar institutions emerging in the US, Germany, France and Indonesia a decade later (Yenawine, 2010).

The microfinance industry started to grow rapidly in the 1950s, driven primarily by the spread of the green revolution in rural Asia and Latin America (Evenson & Gollin, 2003; Harriss-White & Harriss, 2007) to overcome hunger and poverty in these countries. The term 'green revolution' refers to the harvest success in Mexico as a result of modern agricultural practices (Briney & Winter, 2010). During this period, a large-scale rural credit program, subsidised by an international donor, was launched (Robinson, 2005), whereby credit was distributed as a loan to farmers in order to encourage the adoption of new green technologies such as machinery, chemical fertiliser and rice seed.

In the 1970s, the strategy for tackling issues related to the poor shifted from a focus on agriculture to small-enterprise development. People were encouraged to start small businesses to improve their livelihoods as well as reduce unemployment (Schreiner & Woller, 2003). During the 1980s and 1990s, the landscape of MFIs changed slightly, characterised by the emergence of formal MFIs with a high level of supervision, regulation and transparent systems (Cornford, 2001). Since the 1990s, numerous MFIs have been established with a lot of support from international donor agencies, such as the Consultative Group to Assist the Poor (CGAP), the World Bank and the Asian Development Bank (ADB). Moreover, during this period, NGOs began to get involved in microfinancing activities. They combined a credit scheme with development programs to tackle issues regarding education, health and environmental-awareness (Edwards & Hulme, 1995). From the 1990s onwards, MFIs have spread rapidly across the globe in an unprecedented way. There are numerous types of organisations, ranging from informal to formal, each of which has different lending designs, different purposes and different models, including that of the IMFI.

3.2.2. Interest-free (Islamic) MFIs

3.2.2.2. The characteristics of IMFIs

Those main characteristics of conventional MFIs are also applicable to IMFIs. However, the distinctive features of IMFIs are their moral and ethical attributes, which are dictated by the Islamic principles regarding business transactions. Generally speaking, IMFIs are interest-free, while conventional MFIs are interest-based. This is because IMFIs follow the Islamic legal system (*Shari'ah*), and their objectives and operations are based on the principles of the *Quran*. Hence, the philosophy of Islamic finance, including that of IMFIs, goes beyond simply being interest-free (Warde, 2000; Karim, Tarazi & Reille, 2008), in that their operations are required to follow the guidelines set out by the *Shari'ah* principles of business (Allen & Overy, 2009) which include:

1. Prohibition of usury and interest (*riba*)

   The literal meaning of *riba* is increase, addition or growth, and it is most simply defined as the interest paid on a loan. The comprehensive definition of *riba* is "anything (big or small) pecuniary or non-pecuniary, in excess of the principal in a loan that must be paid by the borrower to the lender along with the principal as a condition (stipulated or by custom), of the loan or for an extension in its maturity" (Iqbal & Molyneux, 2005:7). The reason for the prohibition of *riba* is that it is seen as unjust, exploitative and unfair (Saeed, 1995). Charging interest to people who are in need of funds either to meet their basic needs or to support their productive activities is considered to be an exploitative or inequitable transaction.

2. Avoidance of gain from speculation (*mayseer*)

   Earning profit from speculation, such as gambling and its derivatives, is not permitted under *Shari'ah*. However, unlike *riba*, which is absolutely prohibited, the question that often arises is whether the speculation involved in business can be categorised purely as speculation, or as a means to realising gain. In practice, it is hard to distinguish speculation and legitimate commercial speculation. However, Islamic moral values offer the guidance that the level of permissibility depends on the intention. In purchasing shares, for instance, Muslims are guided to differentiate: what is the intention behind acquiring company shares. If the decision is based on the consideration of the company's past and future performance, then it is not considered as speculation but if the decision was made simply because there is an opportunity to make quick profit in a short space of time, then it is considered as speculation.

3. Prevention of risk and uncertainty in transactions (*gharar*)

   Gharar is defined as "the sale of probable items whose existence or characteristics are not certain, this risky nature of which makes the transaction akin to gambling" (El-Gamal, 2006:58). In short, *gharar* comprises of some forms of incomplete information and uncertainty intrinsic in the object of the contract. The main reason for the prohibition of *gharar* is the possibility of unanticipated loss to at least one party who deals in the contract.

4. Promotion of permitted religious activities *(halal*)

   Muslims are encouraged to engage in activities that comply with *Shari'ah*. Hence, they are not permitted to get involved with prohibited businesses such as factories producing products containing pork or alcohol, or gambling and amusement spots, such as casinos. For this reason, Islamic financial institutions (IFIs) are strictly prohibited from financing such businesses, or providing financial services to them.

In short, the economic substance of those principles is to promote the welfare of society and eliminate excessive inequality (El-Gamal, 2006; Karim, Tarazi & Reille, 2008). Hence, the ethical justification for the prohibition of *riba*, *mayseer* and *gharar* is three-pronged: all three are exploitative, unfair, and unproductive (Warde, 2000). The prohibition of *riba* is referred to in the *Quran* (Al Qalam, 2014), as illustrated in Table 3-1.

Table 3-1 The *Quranic* verses relating to the prohibition of *riba*

Surah name	Verse(s)	
Al-Baqarah (The Cow)	275	"Those who consume interest cannot stand [on the day of Resurrection] excepts as one stands who is being beaten by Satan into insanity. This is because they say, "Trade is [just] like interest". But Allah has permitted trade and has forbidden interest. So whoever has received an admonition from His Lord and desists may have what is past, and his affair rests in Allah. But whoever returns to [dealing in interest or usury] those are the companion of fire, they will abide eternally therein."
	276	"Allah destroys interest and gives increase for charities. And Allah does not like every sinning disbeliever."
	278	"Oh you who have believed, fear Allah and give up what remains [due to you] of interest, of you should be believers."
	279	"And if you do not, then be informed a war [against you] from Allah and His Messenger. But if you repent, you may have your principal – [thus] you do no wrong, nor you are wronged."
Ali Imran (Family of Imran)	130	"Oh you have believed, do not consume usury, doubled and multiplied, but fear Allah that you may be successful."
An-Nisa (The Women)	161	"And [for] their taking of usury while they had been forbidden from it, and their consuming of the people's wealth unjustly. And we have prepared for the disbelievers among them a painful punishment."
Ar-Rum (The Romans)	39	"And whatever you give for interest to increase within the wealth of people will not increase with Allah. But what you give in *zakah*, desiring the countenance of Allah – those are the multipliers."

Source: The Meaning of Holy *Quran* (Ali, 1989)

Thus, the moral economy of Islam is that IFIs (including IMFIs) and their customers should both bear the risk of the venture due to the inability of either party to control that venture's success or failure, and the determination of the ex-ante fixed rate of return is strictly prohibited (Chong & Liu, 2009). Since the rate of return for any venture is uncertain, IMFIs adopt a return-bearing contract and apply profit and loss sharing (PLS) based on a formula that reflects their level of participation in a contract/project (Mirakhor & Zaidi, 2007). An IMFI's PLS differs from that of a conventional MFI, which receives consecutive payments during the loan tenure, so its profitability is not affected by the level of a project's rate of return. However, IMFIs, under the PLS approach, posit that the physical investment is part of the institution (Chong & Liu, 2009). Therefore, their profitability is directly linked to the rate of return of the project. As a consequence, the creditors and borrowers both share any profit as well as any loss that might occur. This is also another distinctive characteristic of the IMFI.

Another feature that distinguishes IMFIs and conventional MFIs is the types of products they offer. Based on the PLS scheme, most Islamic finance products and services are based on a partnership contract (Mirakhor & Zaidi, 2007), with the major types of contracts being *mudarabah* and *musyarakah* (Chong & Liu, 2009).

1. The *mudarabah* contract is a profit-sharing agreement in which one party contributes the entire capital needed to finance a project, while the other provides the labour, expertise and management. The profit is shared by both parties, according to a pre-agreed and fixed ratio, and in a loss scenario, the financial institution bears the total loss (Chong & Liu, 2009)
2. The *musyarakah* contract is similar to a joint-venture agreement; both parties jointly contribute the capital and manage the project. Any profit or loss is shared according to a pre-determined agreement (Chong & Liu, 2009)

Mudarabah and *musyarakah* are the fundamental models and the most desirable contracts in any Islamic business context, as the reward-sharing is parallel with risk-sharing among the transaction parties (Dar & Presley, 2000). To date, many products have been developed based on *mudarabah* or *musyarakah*, or the combination of both, such as *ijarah* (leasing), *istisna* (contract manufacturing), *murabaha* (cost plus), and *bai muajja* (deferred-payment sale) (Imady & Seibel, 2006). However, the latter financing contracts have been criticised, as they are seen as being too far removed from the basic model (Dar & Presley, 2000).

3.2.2.3. The development of IMFIs in Islamic countries

The history of IMFIs has not been extensively researched, thus there is a dearth of literature in this area. The spread of Islamic financial services is understood as a broader Islamist agenda, following the Iran Revolution of 1979 (Henry & Wilson, 2004), which aimed to regain the Islamic identity that was destroyed during the colonial rule during the 19th Century. The triumph of the Iranian Revolution is considered to be the beginning of the Islamic resurgence, imbuing Muslim activists throughout the world to bring back the Islamic way of life, including to business Esposito (1999) argues that the emergence of IFIs was perceived as one of the indications of this significant development in Muslim society:

> *"The indices of Islam reawakening in personal life are many...This broader-based renewal has also been accompanied by Islam's reassertion in public life, an increasing in Islamically oriented governments, organisations, laws, banks, social welfare services, and educational institutions. Both government and opposition movement have turned to Islam to enhance their authority and muster popular supports" (Esposito, 1999:10)*

The emergence and development of IMFIs is very often associated with the philanthropic institutions that developed throughout Islamic history: *waqf* (endowment) and *zakah* (almsgiving) and Islamic banks. The institutions of *waqf* and *zakah* have a long history in Islamic civilization (Sadeq, 2002), while Islamic banks only began their operations at the beginning of the 1960s (Dusuki, 2008).

Waqf is simply an Islamic charitable foundation (Çizakça, 1998), but is specifically defined as "the locking up of the title of an owned asset from disposition and allotment of its benefit for a specific purpose or purposes" (Sadeq, 2002:139). The special characteristic of *waqf* is its perpetuity, as its asset and ownership cannot be transferred and can only be used for specific purposes such as financing education institutions, orphanages, roads, establishing mosques, graveyards and so on (Sadeq, 2002). For more than a century, magnificent works of architecture, health, education and welfare activities were entirely financed and maintained by the *waqf* system (Çizakça, 2000). In short, the history of *waqf* is closely linked with the significant achievement in promoting the welfare of society in general and, serving the poor, in particular (Ahmed, 2007).

The other institution that is linked to IMFIs is *zakah*, a compulsory percentage-based almsgiving based on specific items of assets/properties that satisfactorily meet a set of conditions (Ahmed, 2004). While *waqf* is more flexible, the precise conditions of *zakah*, including the eight categories of people (see footnote 2 in chapter 1) who are entitled to receive *zakah* funds, have been established by the *Quran*. The *zakah* mechanism enables the sharing of resources in a society, redistributing income and wealth, thus reducing the socio-economic gap between the rich and the poor (Sadeq, 1996; Kaleem & Ahmed, 2010). Therefore, similar to the institution of *waqf*, *zakah* is also considered to be an effective Islamic tool for the alleviation of poverty.

Throughout history, *waqf* and *zakah* played imperative roles in the Muslim world; *zakah* was the backbone of philanthropy, while *waqf* supported infrastructure (Ahmed, 2004). Since both were administered by the government, the history of these institutions was impacted by the fates of the state (Çizakça, 1998). During the 19th Century, most Muslim countries were under colonial rule, and as a result, to some degree lost their traditions, values and cultural heritage (Iqbal & Mirakhor, 2011), including the Islamic philanthropy institutions of *waqf* and *zakah,* (Çizakça, 1998). Upon these countries' independence from colonial power, Muslims started to rediscover their Islamic identity, and became determined to transform their way of life and bring it into closer alignment with the principles of Islam (Henry & Wilson, 2004) – this reawakening also impacted the financial services sector.

The idea to establish financial institutions in compliance with *Shari'ah* principles was initiated at the beginning of the 1960s, with the establishment of a local savings bank, Mit Ghamr, in Egypt in 1963, which is widely recognised as the first modern Islamic bank (Iqbal & Mirakhor, 2011). However, due to the perceived threat of Islamic fundamentalism by the administration, this bank and its branches were forced to close in 1967 (Valibeigi, 1993; Memon, 2007). Also in 1963, Malaysia established The Pilgrim Saving Corporation, which was then incorporated into *Tabung Haji* in 1969, with the aim of providing an interest-free mechanism to help Muslims save money towards their pilgrimage expenses (Dar & Presley, 2003). Although not much discussed in the literature, the Islamic cooperative bank was established in 1965 in Karachi by S.A. Irshad (Dar & Presley, 2003).

There are several milestones in the history of IFIs (Iqbal & Molyneux, 2005). First is the establishment of the first interest-free institution, which contains ‘bank’ in its name. It is called the Nasser Social Bank, which was established in 1971 by the Egyptian government after the closure of Mit Ghamar (Iqbal & Molyneux, 2005). The main objective was to provide loans to those with low incomes. Second is the establishment of a privately owned bank, Dubai Islamic Bank (DIB), in the United Arab Emirates (UAE) in 1975, which was founded by a group of businessmen. Third, and most important, is the establishment of the Islamic Development Bank (IDB), which aimed to promote *shari'ah*-compliance finance and to reinforce the economic development of Muslim countries. The IDB has played a significant role in expanding the Islamic financing model and supporting a wide range of research in relation to Islamic finance, banking and economics. Since then, a number of Islamic banks and other IFIs were established across the globe. The rapid growth and expansion of Islamic financial services started in the 1980s and continued to grow throughout the 1990s. This growth led to the transformation of the Islamic finance industry into a nascent and specialised one.

In contrast, the development of IMFIs was not as remarkable as that of the Islamic banks. The Muslim Fund Deoband was established and registered as a charitable trust in India in 1961 (Khan & Nisar, 2004). It aimed to release poorer Muslims from the strangle of moneylenders by disbursing interest-free loans without collateral and mobilising the savings from them (Khan & Nisar, 2004). However, while this institution did not fully adhere to s*hari'ah* principles, since India has a secular government and an interest-based banking system (Islahi, 1997), it should be considered to be the first model of the IMFI. There were no other IMFI initiatives until 1986, when Malaysia established a microfinance project called *Project Ikhtiar* (Amanah Ikhtiar Malaysia, 2010). This project replicated the Grameen Bank model, disbursing loans to 373 poor households in the Northwest of Selangor (Amanah Ikhtiar Malaysia, 2010). The project was successful, with the rate of payment reaching about 90%, and hence was formalised into a private trust called Amanah Ikhtiar Malaysia, continuing its aim to provide interest-free loans without collateral to borrowers, for the charge of only a service fee (Ismail, 2001).

Towards the end of the 1990s, another IMFI emerged in Hodeidah, Yemen (Al-ZamZami & Grace, 2001), aimed at helping the refugees of the Gulf War. This project was realised in 1997 with the assistance of the United Nation of Development Program (UNDP) under the Hodeidah Mircofinance Program (HMFP). In the same vein, the UNDP provided support for the establishment of the Sanduq – a local IMFI which was owned and managed by the local people in Jabal a Hoss, Syria, in 2000 (Imady & Seibel, 2003). This program was different compared to other IMFIs, as the mobilisation of funds was undertaken through member-shared capital, which meant that it had multi-shareholders. Another IMFI also emerged in Pakistan in 2001 called the *Akhuwat* (Akhter, Akhtar & Jafri, 2011), where the organisational structure and activities were based on the mosque. The Akhuwat operated without funding from either the government or donors, channelling only interest-free charitable loans (*qard al-hassan*) with the obligation for borrowers to pay just 5% of their loan as an administration fee (Akhter, Akhtar & Jafri, 2011). From the beginning of 2000 onwards, a number of IMFIs were established in various countries in different regions such as the Middle East, South East Asia and South Asia (Allen & Overy, 2009).

3.3. Accountability and governance in microfinance institutions (MFIs)

3.3.1. The importance of accountability and governance for MFIs

Recently, academics and practitioners have paid closer attention to accountability and governance practices in the microfinance sector. In the context of MFIs, governance refers to a "mechanism through which donors, equity investors and other providers of fund ensure themselves that their fund will be used according to the intended purposes" (Hartarska, 2005:1628). Moreover, the governance mechanisms in place will help MFIs to ensure proper discharge of accountability to stakeholders.

There are a number of reasons as to why the issue of accountability and governance is important when it comes to MFIs. Firstly, the tremendous growth in terms of the number of institutions (Dieckmann, 2008), and the subsequent ability of MFIs to reach more customers (Reed, 2013), has significantly increased their assets. MFIs have evolved from being institutions that merely provide single products (primarily credit), to ones that provide a wide range of financial services such as savings, money transfers, remittances, insurance and payment services (Labie & Mersland, 2011). As a consequence, a number of MFIs have transformed their institutional and legal status from being credit unions, NGOs, or cooperatives, to being regulated MFIs that operate like commercial banks. Thus, in accordance with organisational growth, these changes and transformations require an adjustment to the accountability and governance systems in place.

Secondly, MFIs have received massive funds and technical assistance from local, bilateral and international donors (Latortue, Littlefield, Siedek & McKee, 2006; Dichter, 2007). This is because the MFI is considered to be the tool that promises to alleviate poverty and empower people (Dixon, Ritchie & Siwale, 2006; Brau, Hiatt & Woodworth, 2009; Aigbokhan & Asemota, 2011). Therefore, accountability mechanisms will help to identify whether MFIs' resources are utilised properly, and their services distributed to the right beneficiaries (Chritensen & Ebrahim, 2006). Furthermore, governance mechanisms provide direction, to ensure that MFIs do not drift from their objective of helping those on a low-income in a sustainable way (Mersland & Størm, 2010).

Thirdly, MFIs have experienced some major failures in being able to continue their operations, due to a lack of governance (Labie, 2001). A survey on the risk of booming industry demonstrates that the great risk and challenges encountered by MFIs is poor management and weak corporate governance quality (CSFI, 2008). Therefore, improving accountability and restructuring governance mechanisms will help to prevent fraud and failures.

3.3.2. The main issues of accountability and governance in MFIs

There are two main issues related to accountability and governance in MFIs (Rock, Otero & Saltzman, 1998). First is the balance between the dual missions of the MFI, namely, providing financial services to low-income people as well as themselves remaining financially viable in the long-term. Empirical evidence demonstrates that a number of MFIs experience drift from their original mission due to an increased focus on making profits (Mersland & Størm, 2010). Hence, the role of the board is to establish strategic decisions, policies and priorities to achieve superior profitability in order to provide financial services to a greater number of low-income customers.

Second is the various ownership structures of the MFIs. At present, different types of organisations are involved in the microfinance industry, from FPOs to NPOs and cooperatives, with the latter being the oldest form of social enterprise (SE) (Mersland, 2009). Traditionally, the board of directors consists of owners or their representatives. Hence, the way to realise effective governance is to align the interests of individual board members and the interests of the organisation. The alignment of both interests depends on the understanding of the issues corresponding to ownership structures of MFIs (Rock, Otero & Saltzman, 1998).

Historically, MFIs have operated as NPOs in the form of NGOs and SEs, and primarily as cooperatives or credit unions (Epstein & Yuthas, 2010). Due to the issue of financial sustainability, they were then transformed into private banks (Champion & White, 2001). As a commercial bank, the MFI can benefit from legally mobilising funds from society, attracting more savers and borrowers, as well as the possibility in accessing the capital market. However, this transformation brings the consequence of MFIs becoming subject to banking regulations, which thus requires them to enhance their control systems and governance practices they have in place in order to increase the accountability and transparency of their financial reports (Hishigsuren, 2006). Since profitability is the main objective of the owners, the board plays a significant role in ensuring that the director behaves in a manner that serves the interests of owners.

A number of MFIs operate as NGOs, which receive funding from a variety of sources, mainly donors (Epstein & Yuthas, 2010) and have no owners. The main purpose of the board members in such an organisation is therefore to achieve its overall mission. Hence, the governance mechanism might fail if too much of the power is placed in the hands of the executives, because they tend not to receive adequate supervision or guidance from the board (Rock, Otero & Saltzman, 1998). Moreover, the board also has a duty to ensure that the MFI discharges accountability to two main stakeholders: the donors, for the utilisation of resources, and the clients, for the impact of the organisation's services (Edwards & Hulme, 1995) – as well as accountability to themselves for achieving the organisation's dual mission.

A substantial number of MFIs have operated as cooperatives or credit unions. As a democratic-member organisation in which the owners overlap with organisational clients, there are three problematic issues that arise (Rock, Otero & Saltzman, 1998). Firstly, the difficulty of setting priorities among contracted management, member-owners and elected directors. Secondly, the interests of two client groups – i.e. net savers and net borrowers – are not represented equally; generally, the organisation acts in favour of the latter. Thirdly, there is a lack of regulation and supervision from the regulators. Therefore, cooperative MFIs require specific governance mechanisms and structures to ensure that the management discharges their accountability appropriately. This could be done by establishing rules to ensure that the board fulfils its roles and responsibilities of complying with the external auditor's requirements and to perform its operations prudently (Rock, Otero & Saltzman, 1998).

While the focus of accountability and governance in conventional MFIs is to pursue the maximisation of shareholders'/members' wealth, the objective of IMFIs is to achieve social wellbeing. Therefore, the presence of a *Shari'ah* Board is essential to ensuring that the corporation operates in accordance with *shari'ah* principles

(Bhullar, 2011). In this sense, the *Shari'ah* Board plays a role to oversee the operations of the corporation in order to prevent the executives from committing any *riba*, *gharar* or *mayseer* transactions. The board also encourages management to provide services on the basis of mutual benefits.

3.4. Research on accountability and governance in MFIs

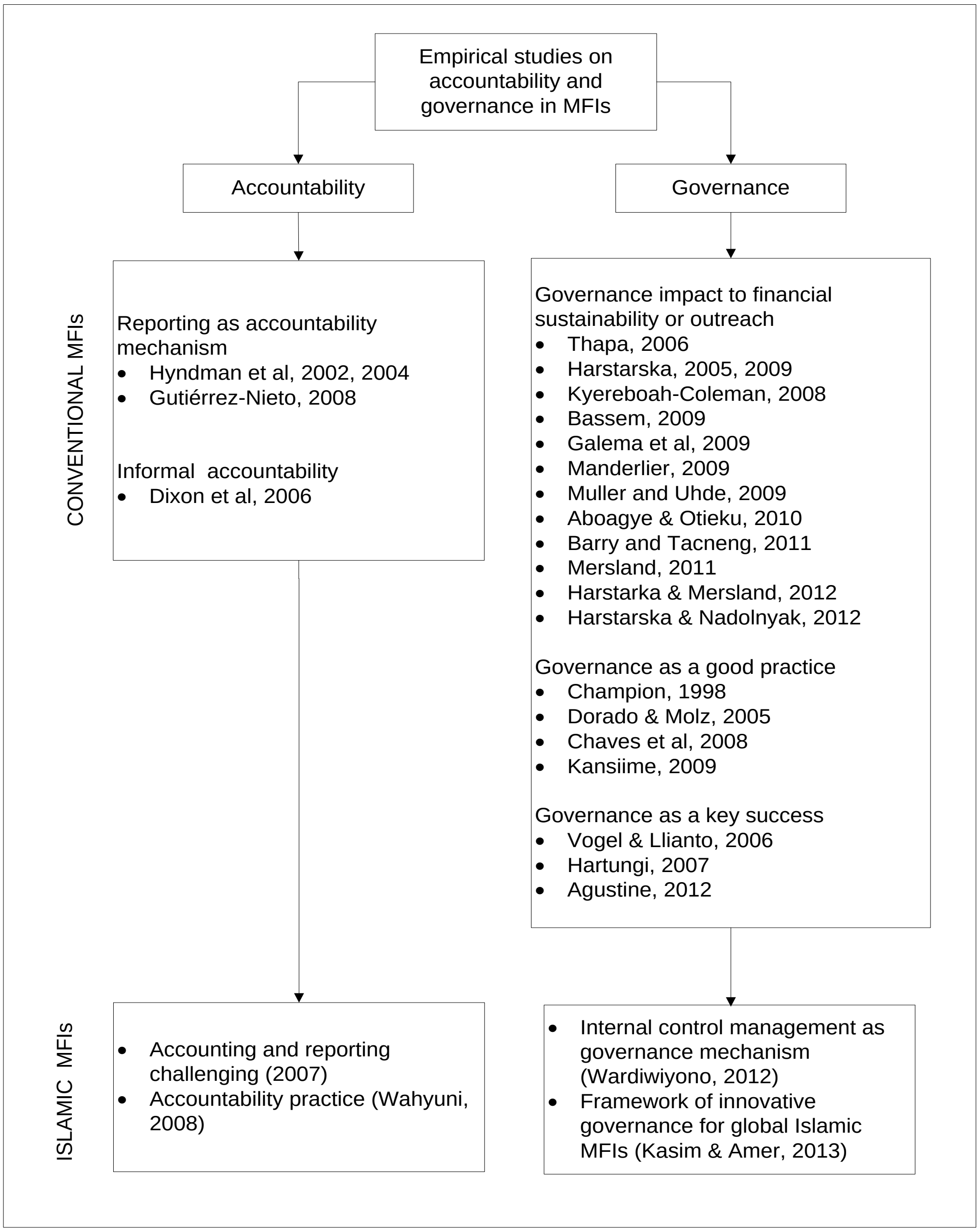
Literature on the MFI has grown enormously, and has been approached from a number of different perspectives. However, the issue of accountability and governance in MFIs has been seemingly overlooked, which therefore means that empirical studies in this area are scant. Resume of studies of accountability and governance in microfinance is attached in Appendix 1. Mapping of the research on accountability and governance in MFIs as found in the published literature is illustrated in Figure 3-2.

3.4.1. Accountability in conventional MFIs

Hyndman et al. (2002) conducted a study to explore the accountability mechanisms practised by credit unions across the UK. They argued that credit unions are accountable to different stakeholders, primarily their members. Hence, they analysed the annual reports of 120 institutions in order to assess the quality of their financial reports and to explore the different types of information, other than traditional financial information that they provided for their members in their annual reports. This study concluded that the accountability provided by credit unions was weak, because the disclosure of basic financial information was patchy. As a result, the users, particularly members, were unable to make rational decisions or judgment calls.

In a different setting, Hyndman et al. (2004) later conducted a similar study on Irish credit unions. The result was, again, that the financial statements that the organisations provided contained inadequate and incomplete information, which meant that they urgently required professional assistance in order to improve the quality of their annual reports, in order for those reports to be more beneficial to users.

Figure 3-2 Mapping the research on accountability and governance in microfinance institutions



Source: Author

Gutiérrez-Nieto et al. (2008) took a different perspective on researching accountability in MFIs. Using samples of publicly available data from the websites of 273 MFIs across the world, they explored the reasons MFIs disclose financial and social reports through their websites. This study revealed different behaviours between large and smaller MFIs in terms of providing information. Large and for-profit MFIs with a high degree of public exposure tended to provide a greater amount of information, mainly financial information, on their websites. Smaller MFIs, on the other hand, disclosed more social information. Adopting the theory of legitimacy, the researchers concluded that the main motive of the managers in the smaller MFIs for publishing financial and social reports on the Internet was to show donors that they had utilised resources efficiently.

Dixon et al. (2006) examined accountability within the context of NGO MFIs in Zambia, and found that, theoretically, they discharge accountability upward to donors and downward to beneficiaries equally. However, in practice, it was difficult to accommodate different stakeholder requirements. As a result, the tension between vertical and horizontal accountability, and a lean in favour of the former, was inevitable. This situation caused pressure and stress among the loan officers, and eventually brought Zambian MFIs into crisis. They concluded that accountability is an omnipresent issue in Africa, and suggested that NGO MFIs should be transformed into for-profit and regulated MFIs, which would mean that they would be subject to banking regulations.

3.4.2. Governance in conventional MFIs

Studies on governance in the context of MFIs are based on the idea that governance is an effective tool for improving their financial performance. Moreover, various governance mechanisms are also considered as a way of guiding MFIs toward overcoming three major issues, known as the 'triangle of MFIs' (Silwal, 2003) – outreach, impact and sustainability – in order to continue providing services in the long term. An MFI is considered to have achieved financial sustainability if it is able to cover all administration and financing costs. Thapa (2006) reviewed the experience of MFIs in Southeast Asian countries that have achieved a certain level of financial sustainability. Thapa (2006) analysed the organisations' financial performance based on data available in the Microfinance Information Exchange (MIX), and identified determinants for their sustainability. This study concluded that while financial viability is essential, it should also be supported by a clear strategic vision, and operated in a transparent and efficient way.

A study to analyse the impact of governance on outreach and sustainability in Central and Eastern Europe was conducted by Hartarska (2005). She examined the internal and external governance mechanisms that affected sustainability and outreach. The study showed that external mechanisms played a limited role, and that among the internal mechanisms, the board played a significant role. Boards with a larger proportion of unaffiliated directors achieved better sustainability. Therefore, she supported for the independence of microfinance boards. In another study, Hartarska (2009) focused only on the impact of external governance mechanisms on outreach and sustainability based on 108 MFIs in 30 countries . The results indicated that among the external indicators, regulation and financial transparency have no impact, while rating agency plays a significant role to discipline. This supports the result of the previous study.

In order to specify which governance mechanisms promote the achievement of sustainability and outreach, Hartarska and Mersland (2012) expanded the scope of the countries being studied. Using data from 155 MFIs in 45 countries, they examined the impact of various governance mechanisms. The result remains the same – that the external governance mechanisms of competition and regulation do not affect performance. Moreover, this study revealed that the presence of donors on the board was not beneficial, and that a larger proportion of insiders in fact caused lower efficiency. In addition to this, the managerial efficiency was found to be improved when the number of board members was up to nine, and decreased when there was more than nine. These findings demonstrated that MFIs have successfully organised their internal governance mechanisms. Similar studies have been conducted in different settings: in the US (Hartarska & Nadolnyak, 2012) and in South Asia (Manderlier, Bacq, Giacomin & Janssen, 2009). These studies delivered the same result: that the efficiency of board increases up to a certain number of board members. Manderlier et al. (2009) also found that no single governance mechanism seemed appropriate to enhance outreach as a measure of social performance of MFIs.

Another study to examine the relationship between governance and MFI performance in European-Mediterranean countries was conducted by Bassem (2009) using a self-conducted survey and annual reports from the MIX. The result was slightly different from Hartarska's studies (2005, 2009; 2012), that external governance mechanisms i.e. regulation and rating agencies, and audited financial reports, have a positive impact on sustainability. Moreover, this study revealed that the size of the board affects MFIs' performance, since the wide range of expertise that gets brought together helps in making better decisions. On the top of this, the study also found that MFIs with higher proportion of women in their boards performed better, thus adding another dimension to internal governance mechanisms. This implies that the diversity of the board is paramount to improving the performance of MFIs.

Not only does the number of board members have a positive correlation with MFIs' performance, but so does the independence of the board and a clear division of the positions, roles and responsibilities between the CEO and the board, i.e. outreach and profitability (Kyereboah-Coleman & Osei, 2008). The imperative role of the board in MFIs was also documented by Dorado and Molz (2004). Using the case of two pioneering MFIs in Bolivia, Bancosol and Los Andes, they investigated the relationship between the roles and composition of the board and organisational evolution. Since the organisations grew in different stages, start-up and build, grow and mature, the roles and composition of the board have evolved and followed the organisational lifecycle. This result supports the results of previous studies on the role of the boards, that they can bring legitimacy, resources and talent to increasing the chance for MFIs to achieve their dual mission.

Another internal governance mechanism that has a positive impact on sustainability is having a powerful CEO – one who also chairs the board of directors – also known as CEO/chair duality (Galema, Lensink & Mersland, 2009). This study found that CEO power has an effect on financial sustainability when there is no stakeholders' elective on the boards. This hypothesis was applicable for non-profit MFIs; where the CEO has more managerial discretion, the performance was harder to measure, and as a result more difficult to control. Therefore, Galema, Lensink and Mersland (2009) suggested that non-profit MFIs should consider adopting the most recent governance practices.

Müller and Uhde (2009) examined the more specific impact of external governance mechanisms on profitability, financial sustainability and outreach using a large range of data from 558 MFIs in 80 countries during the period of 2002–2007. This study provided evidence that external governance mechanism, particularly rules of law and government effectiveness, to have positive impact on MFIs' performance. Müller and Uhde (2009) argued that governments were able to provide invaluable support to MFIs by gradually imposing the implementation of governance practices. Surprisingly, overall economic policies did not affect MFIs, probably due to less exposure of this sector to the country's macroeconomic.

A similar study was carried out by Barry and Tacneng (2011), who analysed the relationship between external governance mechanisms and performance of different types of MFIs in Africa. This study concluded that, compared to other types of MFI organisations, NGO MFIs performed better in achieving profit and outreach. However, the presence of a regulating body as an external governance mechanism merely improved efficiency and productivity, but did not improve performance.

The issue of external governance mechanisms has attracted Mersland (2011) to identify factors that support the survival of savings banks, which started to emerge in the late 18th Century in Europe. Mersland (2011) traced the external governance mechanisms that caused the savings banks to exist as learning lessons for non profit MFIs today. The external mechanisms include: organisation's mission, board, apex association, market competition, influence on local communities, and public regulation. The findings demonstrate that in the absence of public regulation of MFIs, important factors in securing the survival of a savings bank was monitoring by bank associations, donors, depositors, and local communities.

Champion (1998) conducted a survey to log the governance practices of MFIs across the globe. This study aimed to provide mapping of the main issues related to corporate governance of MFIs. The results of the study demonstrated that the governance practices of FPOs and NPOs were more similar than different. Moreover, this study also revealed that there was no division of tasks between the board and the management. These findings demonstrated that organisational structure alone does not have an impact on the determination of governance practices. Based on this result, Champion (1998) suggested that a standard should be developed in order to improve accountability and governance within MFIs.

In a similar vein, Kansiime (2009) carried out a study to identify initiative reforms in Ugandan MFIs to improve the quality of governance standards. Various organisations, from Ugandan microfinance associations to international development agencies such as German Technical Corporation (GTZ) and the United States Agency for International Development (USAID), and international finance or education institutions, were found to have promoted and developed different codes of corporate governance. These reforms were aimed to solve the microfinance crisis in Uganda.

In a specific setting, Chaves et al. (2008) explored the practice of governance in MFI co-operatives in Spain. Since these organisations were democratic member-based organisations whereby the participation of members is paramount, this study focused on how their boards worked to accommodate this principle. The important finding of this study was that member apathy, as reflected by the low attendance rate to annual general assembly, limits discharging of accountability to members. This was because the content of deliberation focused mainly on annual reports, and the members were given limited information about the operations of the cooperatives. As a result, even those who attended had very little input in the meetings, and only a few questions referring to the operations were being asked. In short, this study concluded that the Spanish credit co-operatives still encountered challenges in strengthening member participation that served as a control mechanism for managerial performance.

Vogel and Llianto (2006), Hartungi (2007) and Agustine (2012) attempted to examine the key success factors of MFIs. While studies conducted by Vogel and Llianto (2006) and Hartungi (2007) mainly focused on for-profit MFIs or commercial banking in the Philippines and Indonesia, respectively, Agustine (2012) obtained data from the MIX. Although these studies looked at different types of MFIs, they nevertheless identified that the following governance mechanisms contributed significantly to the success of MFIs: transparency, tight control, internal supervision, internal and external audit, and risk-management systems.

To summarise, a review of the literature of governance and accountability within conventional MFIs indicated that the process of identifying which governance mechanisms have a greater influence on their performance is problematic. Studies examining the relationship between a number of governance mechanisms and MFI performance in different settings and periods have shown different results. At the most extreme end of the scale, a study of 30 rural community banks in Ghana by Aboagye and Otieku (2010) suggested that there was no association between corporate governance and MFI performance. They argued that the adoption of Western corporate governance codes into Ghana's banks was not appropriate. The regulation systems and institutions' infrastructures were still in their infancy. Moreover, from an internal mechanism perspective, the quality of the board and management was weak, and there was no ownership incentive to control or monitor management. This suggests that there is a need for scholars to research governance issues in MFIs from different perspectives, as opposed to examining the relationship between governance and MFI performance. Exploring the social construction of governance practices can be one alternative direction for the research into governance in MFIs.

3.4.3. Accountability in IMFIs

There are limited literatures on IMFI. The existing literatures is dominated by conceptual paper to discuss the potential role of IMFIs in alleviating poverty (Kaleem & Ahmed, 2010; Rahman, 2010; Smolo & Ismail, 2011; Khaleequzzaman & Shirazi, 2012; Rahman & Dean, 2013). Only a few empirical studies conducted on MFIs and the topic varies from the socio-economic impact of IMFIs (Khan, Azam & Khan, 2011; Sh & Ramzan, 2012), the success factor of IMFIs (Adnan, Widarjono &

Anto, 2003; Hosen & Sa'Roni, 2012) or performance evaluation (Masyita & Ahmed, 2013). No prior studies in IMFIs investigate accountability issue, except Wahyuni (2007, 2008).

Wahyuni (2007) conducted an explanatory study to clarify the challenges encountered by IMFIs in Indonesia in discharging accountability. Wahyuni (2007) argued that the rapid development of IMFIs was not in line with the development of regulations and accounting standards. IMFIs had become a growth sector, with more than 3,000 institutions, 30,000 employees, and consolidated assets exceeding more than IDR 1 trillion[5]. While the majority of IIMFIs operate and are legally registered as cooperatives, they are not bound by any specific accounting standards. Since the nature of the IMFIs was closer to that of an Islamic bank, a number of IMFIs adopted the Accounting Standards for Islamic Banking. However, because they were registered legally as cooperatives, they were also required to follow the accounting standards set out for cooperatives. Due to the dual accounting standards available for this sector, the management of IMFIs faced many challenges. This study was based on surveys from 101 institutions across 24 provinces, as well as interviews with the managers of some of these institutions.

Wahyuni's study (2007) identified four major challenges in the processes of preparing accounting and reports. First was a lack of knowledge of Islamic Banking Law. In practice, the operation procedures and standards that had been set up for Islamic banks were not suitable for IIMFIs. As a result, and for the sake of simplicity, a number of transactions were classified into a certain type of contract

[5] About GBP 50,756, exchange rate then being 1 GBP = IDR 19,702 (1st May 2015)

that did not actually fit with the requirements of this contract. Second was the absence of specific accounting principles and standards for this sector. IMFIs adopted different accounting standards, which were divided into two categories: adopting the accounting standards of banks and cooperatives; and recording based on cash basis and accrual basis. As a consequence, their financial reports were incomparable. Third, the low level of human intellectual capital, as only a few people had a sound knowledge of the operations of IFIs. Finally, the operation of IMFIs was not supported by adequate technology or infrastructure.

In another setting, Wahyuni (2008) examined the discharge of accountability practised by co-operative IMFIs in Indonesia. Wahyuni (2008) identified the source of demand for accountability being from the following: IMFI members, monitoring agencies, and the Indonesian Ministry of Cooperative and Small and Medium Enterprise (SME). Data collected from a survey, revealed three major findings. First, although IMFIs faced challenges in preparing financial reports, as suggested by Wahyuni (2007), they claimed that they printed income statements and balance sheets on a regular basis, usually monthly. Second, most of their financial reports were not audited by external independent auditors, and as a result, the quality of their financial reports was unquestionable. Third, the reason that these organisations avoided being audited was that members and other relevant agencies did not expect the financial reports to be audited. Given the limited studies on accountability in IMFIs, this suggests that there are many aspects of accountability that have not yet been explored.

3.4.4. Governance in IMFIs

Similar to accountability, studies on governance in IMFIs are also limited. While studies on governance within the context of conventional MFIs have been dominated by an examination of the relationship between performance and various governance mechanisms, so far only two studies investigate governance issue in the context of IMFIs : Wardiwiyono (2012) and Kasim and Amer (2013).

Wardiwiyono (2012) conducted a study to evaluate the internal control systems (ICS) implemented by IMFI in Indonesia, particularly in relation to financing activities. ICS refers to a system designed to enhance the reliability of financial reporting, to ensure high compliance with law and regulation, as well as to improve the effectiveness and efficiency of an organisation's operations. Based on the primary data from a survey of 30 IIMFIs, and the secondary data from documents published by them, the study highlighted two major issues related to ICS. First is the presence of *Shari'ah* supervisory boards (SSB) that have a responsibility to ensure that products, contracts and transactions are in accordance with *shari'ah* principles. While SSB are essential to IMFIs, Wardiwiyono (2012) found that not all of the institutions have included SSB in their structures. Therefore, the compliance of their operations with *shari'ah* principles can be called into question. Second was the segregation of duties relating to financing activities, namely authorization, recording and disbursement. Authorisation was paramount to prevent fraud and improper financing, but only a small number of IIMFIs included authorisation procedures in their financing activities. Overall, Wardiwiyono (2012) concluded that the internal control mechanisms among IIMFIs were relatively weak. These weaknesses mainly corresponded to the low level of existence of SSB, and a lack of authorisation procedures.

Kasim and Amer (2013) examined the best practice for innovative governance in the context of IMFIs in Malaysia and India by adopting the triangulation method of using both quantitative and qualitative approaches. Innovative governance means the set of internal governance structures, practices and policies that shape innovative governance agendas in compliance with *shari'ah* principles. Kasim and Amer (2013) argued that the implementation of a standalone governance policy was insufficient in a society with a strong Islamic culture. This study concluded that the following six attributes have a positive impact on innovative governance: a high level of *shari'ah* compliance, accountability, independence, competence, confidentiality and consistency. Firstly, the operation of IMFIs should be in accordance with *shari'ah* principles. Hence compliance with *shari'ah* was essential for innovative governance. Secondly, the level of accountability and responsibility of the board of directors, management and *shari'ah* committee helped IMFIs to achieve their goals. Thirdly, the independency of the *shari'ah* committee was important in ensuring that *shari'ah* was considered in the decision-making process. Fourthly, competence, which refers to the standard and expected competencies that are required in ensuring *shari'ah* governance is implemented properly, is found to be significant. Fifthly and sixthly, confidentiality and consistency respectively, outline the basic rules that emphasise the ethical issue of observing and preserving confidentiality, as well as improving consistency in decision making.

3.5. The research gaps

3.5.1. The literature gap

The literature review on accountability and governance in the context of MFIs, both in conventional and Islamic indicates that most studies have considered these issues separately. Research on the accountability of MFIs focuses on the discharge of accountability through providing financial reports, either in hard copy or published on the Internet. On the other hand, literature in the area of governance is dominated by research that examines the relationship between various governance mechanisms and their impact on performance. Therefore, a number of literature gaps can be identified, as follows.

First, the literature fails to draw the issues of accountability and governance within MFIs together into a single study, whereas accountability and governance are interrelated (Jepson, 2005). Accountability is a subset of governance that concerns with the everyday practice of giving account and communicating, while governance systems are concern with strategic issues of how an organisation is directed. So governance mechanisms will help to ensure that all members of an institution are accountable. Therefore, this study contributes to the existing body of literature by incorporating both concepts of accountability and governance into the study. Studying these issues separately neglects the important relationship between accountability and governance, thus failing to provide a holistic understanding of their effect on IMFIs.

Secondly, there is a dearth in the literature on accountability and governance within IMFIs. Traditionally, studies on accountability and governance were focused on listed and profit companies. Therefore, research on accountability and governance by Karim (1995), Haniffa and Hudaib (2007), Nathan & Ribière (2007), Ghayad (2008), Mimoun (2009), Rammal (2010) and Ginena (2013), to name a few, has been dominated by research within Islamic banks. Hence, a study on IMFIs will broaden the scope of research on accountability and governance in terms of sector and context, as suggested by Brennan and Solomon (2008). Moreover, this study is conducted in a specific context, i.e. IMFIs that operate within an unregulated environment, lack of supervision from the government and the absence of accounting and reporting standards for this sector.

Thirdly, the literature focuses too heavily on investigating the relationships between different accountability and governance mechanisms with financial performance, financial viability or outreach. Hence, studies in this area tend to overlook the dynamic aspects of accountability and governance. There is no single model of accountability and governance that fits all organisations. Moreover, historical and cultural contexts should be taken into account in discussing the development of accountability and governance within the organisation. Therefore, this study attempts to explore how accountability and governance practices were constructed in selected cases of IMFIs in Indonesia.

3.5.2. The methodology gap

In terms of methodology, there are two main gaps in the literature on accountability and governance in MFIs. First, the research on governance has predominantly been conducted using quantitative approaches in order to examine the relationship between governance and performance, with only a few exceptions (Dorado & Molz, 2004; Kansiime, 2009; Mersland, 2011). Although few studies adopted a mix method by combining surveys and interviews (Wardiwiyono, 2012; Kasim & Amer, 2013), the discussions were based mainly on the quantitative data. Similar to studies on governance, the majority of research into accountability has been dominated by quantitative or mixed-method research, except Dixon et al. (2006). Since this research is an exploratory study, it is therefore inappropriate to adopt a quantitative approach.

Secondly, while there are a number of research designs available, such as phenomenology, grounded theory, narrative research, case study or ethnography, most studies of MFIs that have adopted a qualitative approach (Dixon, Ritchie & Siwale, 2006) failed to specify the research design they adopted. Due the nature of this study, in that it aims to investigate the development of accountability and governance practices within IMFIs as driven by Islamic values, it requires the researcher to understand the organisations' cultures and daily operations. Therefore, an ethnography approach was chosen as it will enable collection of 'thick' data.

3.5.3. The theory gap

In terms of theory, prior studies on accountability and governance in MFIs have been guided by traditional agency theory or stakeholder theory (Hartarska, 2005; Labie & Mersland, 2011; Mersland, 2011; Hartarska & Mersland, 2012). Therefore, most of the literature focuses on how to regulate MFIs, and how board structures and procedures can enhance MFI performance. Despite the fact that these studies demonstrate a step forward in the research around MFIs, there remains a need to adopt the theoretical perspectives beyond agency theory and stakeholder theory. This aims to broaden the scope of accountability and governance research, such as examining MFIs from an historical perspective and looking for lessons from it to apply to current MFIs (Labie & Mersland, 2011).

This study takes a different direction in broadening the research on accountability and governance by adopting a theory of practice developed by Pierre Bourdieu (1977). Since the aim of this paper is to explore how accountability and governance practices are developed and practised, Bourdieu's conceptual tools are useful in providing guidance to help identify the practical logic of a certain practice. Bourdieu's conception of *habitus* has been successful in explaining the variations of accountability *practices* in different organisations that operate in similar sphere (Goddard, 2004). Furthermore, Bourdieu's conception of the *field* help in understanding how a particular sector such as Islamic microfinance sector emerged and influenced the practice of accountability and governance of IMFIs.

3.6. Summary and conclusion

This chapter present a review of the literature related to accountability and governance in MFIs, with the aim of identifying the research gaps and thus filling those gaps through conducting this study.

This chapter began by discussing the importance of and main issues surrounding accountability and governance in MFIs, and continued to map the research on separate bodies of accountability and governance literature in both conventional MFIs and IMFIs. By mapping the literature, the research gaps in terms of literature, methodology and theory, have been identified. Given the paucity of literature on accountability and governance in IMFIs, this study seeks to investigate the construction of accountability and governance practices within selected IMFIs in Indonesia that contributed in improving financial performance and sustainability in long term.

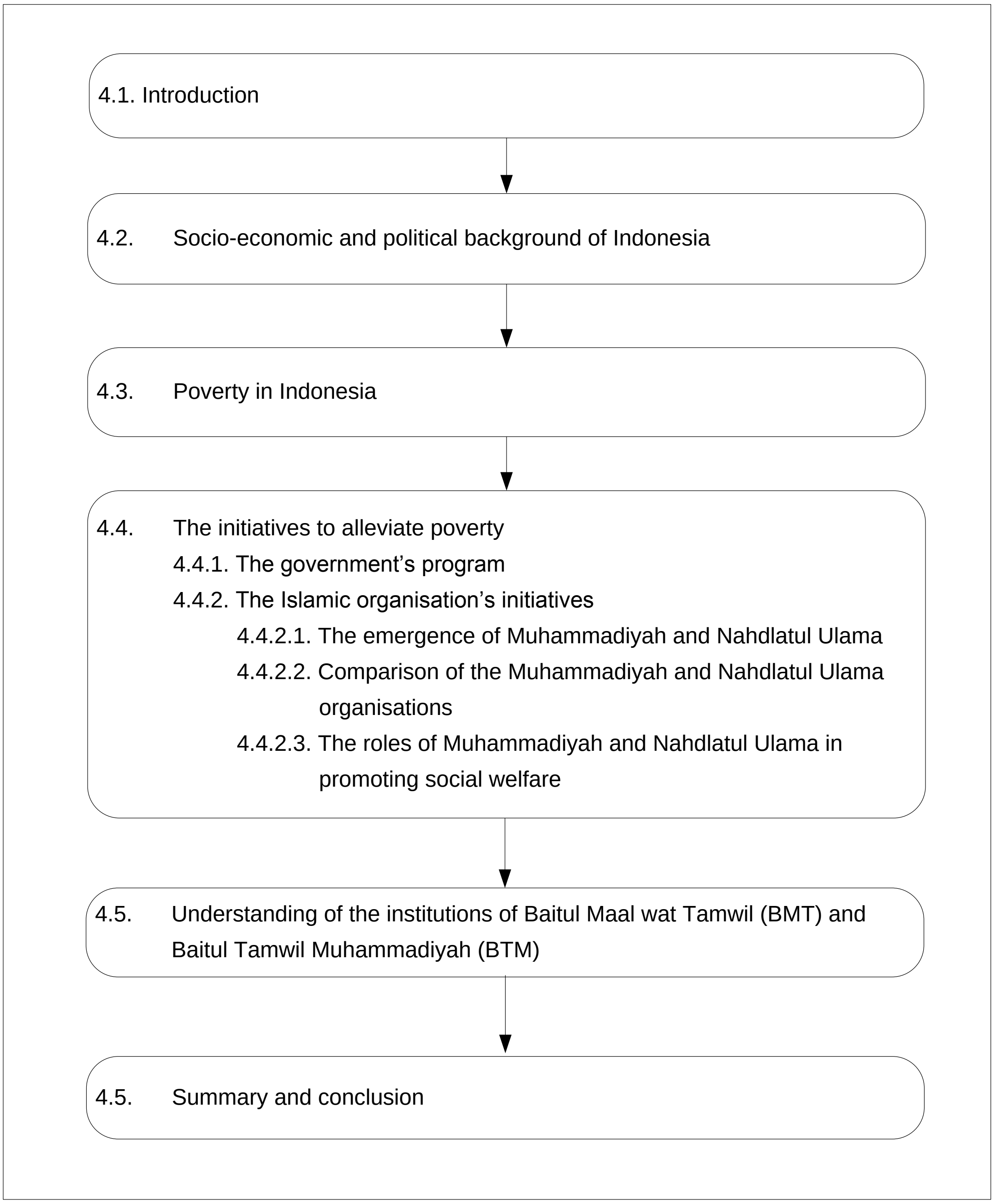
Since the focus of this study is on IIMFIs, it is important to have a general understanding of the country context in order to appreciate discussions of the findings. Hence, the next chapter will describe the socio-economic and political environment of Indonesia.

CHAPTER 4 THE CONTEXT OF RESEARCH

4.1. Introduction

This chapter aims to provide the country context of the research by focussing on the poverty profile and the initiatives of poverty alleviation programs. It begins by explaining the general socio-economic and political background of Indonesia and the omnipresent poverty. It also briefly discusses the programs launched by the government to reduce poverty and the role of Islamic organisations in alleviating poverty in the country. The structure of chapter 4 is illustrated in Figure 4-1.

Figure 4-1 The structure of chapter 4



4.2. Socio-economic and political background of Indonesia

Indonesia is an island state in Southeast Asia, between Asia and Australia. With a population of more than 237 billion in 2010 (Badan Pusat Statistik, 2010), Indonesia is the fourth most populous country in the world after China, India and the US. Moreover, as the majority of the population, or 87.2% (about 206 million), identify themselves as Muslims, Indonesia is recognised as having the world's largest Muslim population (Desilver, 2013). However, Indonesia is not an Islamic state, Indonesia's ideology is Pancasila (five principles). The first principle is Belief in One Supreme God and Indonesia recognise six religions : Islam, Protestantism, Catholicism, Hinduism, Buddhism and Confucianism.

Administratively, Indonesia is divided into 33 provinces, each of which is led by independent governors. Historically, Indonesia has experienced great political upheaval. There was always conflict between Indonesian Islam and Ducth colonialism from 1596, continued during the Japanese occupation 1943-1945 (Steenbrink, 2006). After Japan surrendered in 1945, independence was proclaimed by the leader of the independent movement, Sukarno, who became the first president and remained in office until 1965. His successor, Suharto, ruled the country for more than 32 years before stepping down after the 1998 riot. Since 2004, Indonesia has undergone transition to democracy whereby the direct presidential election system was applied until present (Hill & Shiraishi, 2007).

Islam has played a significant role in shaping Indonesia's political landscape (Pringle, 2010), because historically, religious authority and political power have always been intertwined (Ichwan, 2005). The separatist movement that occurred during the Sukarno era, which attempted to establish Indonesia's Islamic state, ended unsuccessfully (Tamara, 1986; Bruinessen, 2002; Elson & Formichi, 2011) and left a negative image of Islam. Hence, President Suharto imposed a policy to curtail Islamic political power, which stood to imperil the unity of the State and limit its activities to those related to religious piety and the cultural and social domain. At the very beginning of his rule, he emulated his predecessor's policy toward Islam by overseeing all Islamic activities and repressing their reformists. However, the regime's attitude towards Muslims started to soften following his companionship with a group of Muslim intellectuals. In an even more uncharacteristic move, Suharto gave his blessings to the establishment of the first broad-based organisation of Muslims, *Ikatan Cendekiawan Muslim Indonesia* (ICMI – the Organisation of Indonesian Muslim Intellectuals) in December 1990. Later, ICMI played a significant role in reshaping the image of Islam in political, social and economic life.

Similar to Indonesia's political history, the story of the country's economy has been a tumultuous one. During President Sukarno's era, Indonesia encountered economic difficulties due to the long period of exploitation it suffered during the Dutch colonial period, the significant and increasing government expenditure on financing military activities during the period of struggle for independence, and the political instability during the period of hostility between the various political parties (Wie, 2003). Learning from his predecessor, President Suharto imposed military power to stabilise the political situation, and adopted a stabilisation policy to boost economic development (Cole & Slade, 1998). Therefore, during the first twenty years of President Suharto's reign, Indonesia underwent rapid economic growth. This was the result of the liberalisation of foreign exchange, which increased the inflow of direct foreign capital to Indonesia and the increase in the price of oil in the world market, which in turn increased the government's profit from oil exports (Sundrum, 1986).

The Indonesian economy continued to grow and in 1993, the World Bank held Indonesia up as an example of an economic miracle (Fane, 1999). However, the economic miracle turned abruptly into financial crisis, due to the effect of the Thai Baht collapses in July 1997. In January 1998, the exchange rate of Indonesian rupiah touched around 16,500 per US dollar, compared to about 2,500 before the crisis (Hadiz, 2001). As a result, much of Indonesia's corporate sector went into insolvency due to the massive depreciation of real exchange caused by the sheer size of their liabilities (Fane, 1999). The economic and financial crisis was then followed by the collapse of President Suharto's regime (Hadiz, 2001). After the economic crisis of 1997–1998, Indonesia's economic growth remained more subdued at around 5%, compared to 7% before the crisis (Hill & Shiraishi, 2007). Moreover, Indonesia's economic crisis had a significant impact on the increasing levels of poverty in the country (Suharyadi & Sumarto, 2003), which will be discussed in the next section.

4.3. Poverty in Indonesia

Indonesia has demonstrated substantial economic growth over the past decade. Despite these impressive achievements, the number of poor people who live under the poverty line of USD $21 per month remains high (Baker, Burger, Glick, Perez-Arche, Rabinovich, Yashodara, Srinivasan & Young, 2013). The profile of poverty in Indonesia during the period of 1976–2013 is presented in Table 4-1.

Table 4-1 Poverty in Indonesia (1976-2013)

Year	Number of poor people (million)	Percentage of poor people (%)
1976	54.20	40.10
1980	42.30	28.60
1984	35.00	21.60
1990	27.20	15.10
1996	22.50	11.30
1998	49.50	24.20
2000	38.74	19.14
2007	37.17	16.58
2008	34.96	15.42
2009	32.53	14.15
2010	31.02	13.33
2011	29.89	12.36
2012	28.59	11.66
2013 (by March)	28.07	11.37

Source: *Badan Pusat Statistik* (2013)

According to *Badan Pusat Statistik* (Statictics Indonesia) the number of poor people in Indonesia reached 54.2 million or 40.10% of the population in 1976. This number decreased gradually and became the lowest in 1996 with the number of people in Indonesia classed as poor being about 22.5 million. However, due to the financial crisis of 1997–1998, the number rose sharply and more than doubled reaching 49.5 million at the end of 1998. The crisis, therefore, forced a large number of households into poverty in a very short space of time (Suharyadi & Sumarto, 2003). From the time of the financial crisis until the present day, poverty alleviation has remained as the main agenda of the government, but the level of poverty has not returned to the pre-crisis level of 1996 because the growth of the population is also relatively high (Sumarto & Widyanti, 2008).

Using the international poverty line of $2 per day, the World Bank estimated that 49% of the population remained vulnerable to poverty (Sumarto & Widyanti, 2008).

This means that the risk or probability of a household becoming poor in the near future is still very high. Moreover, poverty in Indonesia has many dimensions. By using a non-monetary indicator i.e. access to public services, the 2004 National Socioeconomic Survey reveals that 57.45% of the population has no access to drinking water, and 44.4% experience lack of sanitation. Moreover, about 44% of people rely on traditional midwife during birth, and 28.19% of the population does not send their children to further study at secondary level (Sumarto & Widyanti, 2008). In short, the poverty profile illustrates that poverty and its multidimensionality remain a serious problem in Indonesia, requiring holistic approaches and strategies to overcome this issue in sustainable ways.

4.4. The initiatives to alleviate poverty

4.4.1. The government's program

Poverty alleviation has become a major driver of policy initiatives in Indonesia for many decades (Maksum, 2004), with the government having designed different strategies and instruments in order to reduce poverty (Antonio, 2008; Suryahadi, Yumma, Raya & Marbun, 2010; Baker, Burger, Glick, Perez-Arche, Rabinovich, Yashodara, Srinivasan & Young, 2013). In general, based on the classification of beneficiaries, the programs to alleviate poverty can be classified into three clusters: social assistance, community development and micro-enterprise empowerment (Suryahadi, Yumma, Raya & Marbun, 2010). The first cluster aims to fulfil the basic needs of all categories of poor people such as food, education, clean water, health and sanitation through programs such as scholarship for poor children. The second cluster focuses on community empowerment aimed at encouraging poor people to get involved in the development programs that will enable them to increase their income. The last cluster is targeted at small and medium enterprises to broaden their financial accessibility and improve their economic performance. The main goals for clustering the program is to encourage poor people to gradually move from the first cluster to the second cluster, and then to the third cluster, and finally they are able to entirely move out from poverty.

The evaluation on the effectiveness of the programs has shown mixed results (Suryahadi, Yumma, Raya & Marbun, 2010) due to a number of reasons. Poverty has multidimensional impacts (Sumarto & Widyanti, 2008), there exist disparity problems between rural and urban poverty (Baker, Burger, Glick, Perez-Arche, Rabinovich, Yashodara, Srinivasan & Young, 2013) and the number of poor people to manage is relatively high (Badan Pusat Statistik, 2013). Consequently, it is hard to implement one program that fits all situations. Furthermore, the government has limited capacity in terms of budget and human resources to develop and implement different poverty alleviation programs. Therefore, other initiatives have emerged from the civil movement, for instance, from the Islamic mass organisations.

4.4.2. The Islamic organisation's initiatives

According to a survey conducted by the Islamic Research and Training Institute (IRTI), more than half a billion of the world's poor live in the Islamic world, particularly in Indonesia, Bangladesh, Pakistan, Nigeria and Egypt (Obaidullah, 2008). Since the majority of the Indonesian population is Muslim, and almost half of the population is vulnerable to poverty (Sumarto & Widyanti, 2008), this suggests that it is highly likely that the poor and needy group is principally Muslim. For this reason, the Islamic social movements of *Muhammadiyah* and *Nahdlatul Ulama*

(NU), which literally means ‘revival of religious scholars (*ulama*)’, emerged during the period of Dutch colonial rule, and have continued through to the present. Prior to discussing the role of those organisations in alleviating poverty and improving social welfare, the historical background and a comparison of these organisations are outlined.

4.4.2.1. The emergence of *Muhammadiyah* and *Nahdlatul Ulama*

The *Muhammadiyah* was established on 18 November 1912 after the Dutch imposed a policy that prohibited Islamic organisations from getting involved in politics (Benda, 1958), and also due to the perception that the socio-religious life of Muslims was deemed to have deviated from the ideals of Islam. Despite Islam having been present in Indonesia for centuries, it had yet to penetrate deeply into Indonesian society, as many still practised popular customs that were imbued with pre-Islamic traditions (Anwar, 2005). Concerned by “the impurity of religious life, the inefficiency of religious education, the activities of Christian missionaries, and indifference and even anti-religious attitude on the part of the Indonesian intelligentsia” (Anwar, 2005:30), Ahmad Dahlan established *Muhammadiyah*. From Dahlan’s perspective, the existing *pesantren* (a traditional Islamic institution that has existed in Indonesia since the 16th Century) was insufficient for coping with those issues (Maarif, 2001). Therefore, Ahmad Dahlan set the objective of *Muhammadiyah*, which was to purify the traditional practice of Islam through education by teaching Islam alongside modern subjects (Fuad, 2002). Dahlan’s idea was very much influenced by the Egyptian modernist movement started by Muhammad Abduh, who argued that reforming Islamic education throughout the

Muslim world was the basic prerequisite to creating a society based on ethics (Anwar, 2005).

From Dahlan's point of view, it was necessary to reshape the religious understanding of Indonesian Islamic society (*ummah*) by bringing Muslims back to the *Quran* and *Sunna*.[6] *Muhammadiyah* was determined to purify the faith from associating other gods with Allah (*shirk*), superstition (*khurafat*) and cleansing ritual observance from innovations (*bid'a*), which were widely practised and contained an element of pre-Islamic beliefs (Anwar, 2005). For this reason, the *Muhammadiyah* was considered to be a modernist or reformist Islamic movement (Barton, 1997). Through religious education and social welfare activities, the modernist movement expanded rapidly in Java and Sumatera (Federspiel, 1970).

In order to counterbalance the rapid growth of modernist Islam, NU was founded in 1926 by a group of *ulama* led by Kiai Hasyim Asy'ari in Surabaya (Fealy & Barton, 1996; Turmudi, 2006). The establishment of NU was considered to be a traditionalist movement, since its aim was to preserve traditional Islamic learning and practice (Barton, 1997) within the *pesantren* or traditional Islamic institution as the backbone of the traditionalist (Nilan, 2009).

The efforts of the modernists to purify Islamic practice was deemed as confrontational to traditionalists, as they were more accommodating in nurturing local practices (*adat*) (Turmudi, 2006). *Adat* is the local customary practices and tradition of Indonesian ancestors who were obviously not Muslims. Since more and

[6] *Sunna* refers to the words, life, practice, behaviour and actions exemplified by the Prophet Muhammad during his lifetime, which recorded into *Hadith*, as discussed in Chapter 2, Section 2.3.

more of them became Muslims, *adat* was gradually adapted to Islam (Bruinessen, 1996b). From the modernist point of view, the practice of traditionalists was still a mix between Islam and *adat,* which by nature contains non-Islamic origins. On the other hand, the traditionalist *ulama* emphasised that they will strive to stop *adat* practices that contradict *shari'ah*. The difference between *Muhammadiyah* and NU is further discussed in the next section.

4.4.2.2. Comparison of the *Muhammadiyah* and *Nahdlatul Ulama* organisations

Religion plays a significant role in the formation of society (Mughni, 2009). When NU and *Muhammadiyah* were first established, both grew quite slowly, but after many decades, both organisations flourished to become the first and second biggest Islamic organisations in Indonesia, respectively. The number of NU followers in Indonesia is estimated to be about 40 million (Mujani & Liddle, 2009) while that of *Muhammadiyah* is about 30 million (Saragih, 2012), thus becoming the most influential social organisations in Indonesia. The presence of NU and *Muhammadiyah* demonstrates that as the most populous Muslim country, Indonesia is actually heterogeneous in terms of religious practice (Turmudi, 2006). From the onset, the religious doctrine and sociological foundations of *Muhammadiyah* and *NU* were different (Pringle, 2010).

The main difference between *Muhammadiyah* and NU lies in the doctrinal dimension which derives from the difference in the interpretation of the precepts of the Holy *Quran* and the *Hadith* (Turmudi, 2006). The sources of practising Islam underpin the traditionalist movement are the *Quran*, the *Hadith*, *Ijma* (concensus) among *ulama*, and *qiyas* (*analogy*), while those of the modernist movement rely only on the *Quran* and *Hadith* (Turmudi, 2006). Consequently, *Muhammadiyah* members perform only what is religiously ordered as espoused in the *Quran* and *Hadith*, and any religious practices that were not exemplified by the Prophet are commonly called *bid'a* (heretical practice). *Muhammadiyah* members rejected and strictly prohibited any heretical Islamic practices and suggested that *bid'a* is *zolala* (going astray). By contrast, NU does not consider that all *bid'a* are bad, since only the bad *bid'a* can lead Muslims to hell. There were a number of good *ibada* (Islamic rituals) that can be classified as *Sunna* (recommended), the performance of which can be considered as being complementary to religious obligations, which may have been performed imperfectly.

Moreover, traditionalists follow the *Shafi'i Madh'hab* (Islamic school of thoughts or jurisprudence), while modernists rely on their reasoning and are not related to any *Madh'hab*.[7] While the differences above do not actually touch on the basic theology of Islam, they differ in terms of worldview as expressed in the practice of everyday rituals as well as social behaviours of its members. These different practices have provoked latent conflicts, since modernists consider their Islam to be purer and better, while traditionalists regarded the *Muhammadiyah* to be too rigid and puritan, since it overlooked the existing socio-cultural environment (Turmudi, 2006). While this situation has been heightened for many decades, nowadays the disagreements

[7] There are four dominant Islamic school of thoughts or *Madh'hab*. The Shafiʿi school was founded by Muhammad ibn Idris ash-Shafiʿi is followed by Muslims in South east Asia, Somalia, Jordan, Palestine and Yemen. The Hanafi school was founded by Abu Hanifa an-Nu'man and is followed by Muslims in Central Asia, South Asia, Iraq, Turkey, the Balkans and by most of Russia's Muslim community. The Maliki school was founded by Malik ibn Anas and is followed by Muslims in North & West Africa, UAE, Kuwait, and parts of Saudi Arabia. The Hanbali school was founded by Ahmad ibn Hanbal and followed by Muslims in Qatar and Syria Sharif, M. J. & Ijaz, M. (2014) Madhhab in Islamic law and the dissemination of Sunni's legal text. *VFAST Transactions on Islamic Research*, 5,2, 1-8.

between the traditionalists and the modernists have become blurred since modernists have become less radical in their rejection of traditions (Bruinessen, 1990).

In terms of the sociological aspect, the traditionalist NU members tend to be less educated, with the majority living in rural areas of Central and East Java, while the modernist *Muhammadiyah* comprises middle-class professionals or bureaucrats who are well educated people of a higher economic standing, who tend to live in the urban areas of Java and Sumatera (Mujani & Liddle, 2004; Bush, 2014).

From the organisational-structure point of view, the structure of *Muhammadiyah* is, in descending order from the top, is the national office, the provincial office, the district office, branch office and sub-branch office (Fuad, 2004). The national office establishes regulations around the activities that occur among the different levels of *Muhammadiyah* offices, and the decisions are binding and must follow the organisational hierarchy. Moreover, the central office also sets the binding mechanism that any assets and endeavours carried out should be under the name of *Muhammadiyah*. Such organisational arrangements are viewed to be one of the reasons as to why *Muhammadiyah* is seen as being modernist (Fuad, 2004).

Similar to *Muhammadiyah*, NU's administrative office also exists from the national level to the village level. However, the decisions made by the higher-level council does not automatically bind the lower-level council because NU is not a centralised hierarchy (Nakamura, 1981). NU is essentially a collegial alliance or federation of independent *ulama*. Accordingly, the root structure of NU is based on the charisma of individual *ulama*, each of whom is the proprietor of his own domain (Fuad, 2004). Table 4-2 summarised the main differences between the two organisations.

Table 4-2 A comparison between NU and *Muhammadiyah*

Aspects	NU	*Muhammadiyah*
Orientation	Traditionalist	Modernist or reformist
Adherence to Islamic school of thought	Follow *Syafi'i Madh'hab*	Does not follow any *Madh'hab*
Source for Islamic practice	The *Quran*, *Hadith*, *Ijma*, *Qiyas*	The *Quran* and *Hadith*
The number of followers	About 40 million	About 30 million
Characteristics of the followers	Rural Java, farmers, less formal education	Urban cities, middle class and educated
Organisational structure	Descending from national office to village office, in which the decision of higher-level office does not automatically bind lower level office	Descending from national office to village office, in which the decision of higher-level office binds the lower-level offices
The ownership	Individual *ulama*	*Muhammadiyah's* institution

Source: Author

Although they are different in many aspects, both *Muhammadiyah* and NU have shaped the development of culture, politics and social life within Indonesian society, including the promotion of social welfare (Arnez, 2010). Their roles in promoting social welfare will be discussed in the next section.

4.4.2.3. The roles of *Muhammadiyah* and *Nahdlatul Ulama* in promoting social welfare

From the onset, *Muhammadiyah* has focused its activities to propagate Islam, empower the *ummah* (Islamic society) and improve its social condition through education and social programs (Fuad, 2002). The founder, Ahmad Dahlan was an *ulama* and entrepreneur who travelled from one place to another to conduct business and teach Islam. He was concerned with the poverty and backwardness of people in the Netherlands East Indies (the designation of Indonesia during the Dutch period), the majority of whom belonged to Muslim *ummah* (Arnez, 2010). He emphasised the importance of philanthropy in Islam by excerpting verses in the *Quran*. He brought the message that he would not stop teaching such verses until his followers help the poor (Mughni, 2009).

The spirit to help poor people was eventually internalised in the minds of *Muhammadiyah*'s followers. Up to the present day, *Muhammadiyah* has propagated Islam through education and social programs, which are supported by more than 11,700 branch offices at provincial, district, sub-district and village levels (Bush, 2014). They control more than 8,000 kindergartens and 9,800 elementary and high schools, 500 health services, 300 orphanages, 174 universities, and a number of economic institutions such as banks, markets and gas stations (Mughni, 2009; Bush, 2014). Moreover, they are also concerned with empowering women and young people by becoming an umbrella organisation for autonomous organisations such as *Nasyiatul Aisyiyah* (*Muhammadiyah* Young Women's Movement), *Aisyiyah* (*Muhammadiyah* Women's Movement) and *Pemuda Muhammadiyah* (*Muhammadiyah* Young Men's Movement) (Fuad, 2004).

While *Muhammadiyah* is a unified organisation and by virtue has a legal ownership, NU lack these elements. The proprietors of *pesantren* are autonomous *ulama* (Fuad, 2004), and hence it is difficult to obtain the statistics of the number of organisations affiliated to NU. However, the social development occurred as a result of the unanimity of the 28th NU congress of 1989, which shifted the organisational orientation from political involvement to community-oriented activities (Bruinessen, 1996a). Education, social-activity and welfare programs were performed by thousands of *pesantren* and autonomous organisations under the NU, such as *Fatayat* NU (young women's organisation), *Muslimat* NU (women's organisation), student association of NU and a number of professional-based organisations comprising of labour, teachers and Islamic scholars.

Studies indicate that the backbone of NU, i.e. *pesantrens*, have played a significant role in community development by promoting the basic rights of children, encouraging women's political rights, empowering women and building religions for peace in a pluralistic community (Mulia, 2007; Arnez, 2010). Furthermore, a recent survey of around 500 households across nine *pesantren* in Indonesia shows that living around the *pesantren* brings direct benefits due to the increasing participation in religious activities, which also indirectly affects their socio-economic conditions, probably due to the networking effects (Permani, 2011).

Supported by approximately over 14,000 *pesantren* that are affiliated to NU, the foremost and obvious role of NU, therefore, is promoting education and spreading Islam throughout the archipelago (Pohl, 2006). Indonesian *pesantren* have the distinctive characteristic that they were owned and run by individual *ulama*, who may promote a particular ideology or interpretation of Islam (Rabasa, 2005). According to Dhofier (1980), the education system of a *pesantren* constitutes traditional life: the mosque as a religious and social education centre, the student (*santri*) lives in student dormitories (*pondok*) and are taught the classical Islamic text (*kitab kuning*) by the *pesantren* leader (*kiai*). They operate as boarding schools and provide traditional, non-formal Islamic education, and do not issue their graduates with recognised certificates. This is in contrast to the education system of the modernist *Muhammadiyah*, which operates as a religious day school and adopts the *madrasah* system, which itself uses a structure of 70% secular subjects and 30% religious subjects. Therefore, this system enables graduates to pursue a higher level of education (Pohl, 2006).

In terms of helping poor people as a virtue of Islamic precepts, *Muhammadiyah* and NU have both been at the front line of Islamic philanthropy in Indonesia. They established specific councils in order to collect and distribute *zakah* (almsgiving) and *sadaqah* (charity or donations). The presence of such institutions is important in Islamic society for the redistribution of income and wealth, as well as in diminishing social and economic inequality within society (Kaleem & Ahmed, 2010). Rather than giving money directly to the poor, *zakah* funds are utilised for innovative programs, such as providing scholarships, delivering healthcare programs and empowering youth communities (Lessy, 2009). In short, NU and *Muhammadiyah* play imperative roles in empowering society, strengthening civil society and enhancing social-welfare in Indonesia. Moreover, as an effort to help people to alleviate poverty in a sustainable way, the followers of *Muhammadiyah* and NU help to establish financial services for the poor based on Islamic teachings, known as the *Baitul Tamwil Muhammadiyah* (BTM) and the *Baitul Maal wat Tamwil* (BMT) (Seibel & Agung, 2005), which will form the case study for this research. The concepts of BMT and BTM will be discussed in the next section.

4.5. Understanding the institution of *Baitul Maal wat Tamwil* (*BMT*) and *Baitul Tamwil Muhammadiyah* (*BTM*) institutions

The terms *Baitul Maal wat Tamwil* and *Baitul Tamwil Muhammadiyah* are used as generic names for IMFIs in Indonesia (Seibel & Agung, 2005). The literal meaning of *Baitul Maal* is 'a house of treasure/money', while that of *Baitul Tamwil* is 'a house of business/expense' (Muftie, 2012).

Baitul Maal is one of the oldest Islamic institutions, having already existed since the era of Prophet Muhammad (despite being not very well established back then). It was transformed into a vital economic institution during the rule of the Caliph Umar, with the aim of accumulating *zakah* to be distributed to those in need and used for public purposes such as constructing bridges or roads, and providing social services (Sirojudin & Midgley, 2011). So, the concept of *Baitul Maal* today is probably akin to the Ministry of Finance, Ministry of Social Affairs, Directorate of General Taxes and Ministry of Public Works (Possumah & Baharuddin, 2012). *Baitul Tamwil,* on the other hand, is translated in many literature as 'house of business' (Sakai & Marijan, 2008; Juwaini, Rambe, Mintarti & Febrianto, 2010). However, it is difficult to find references on the concept in order to understand the nature and history of how and when it was practised.

The concepts of *Baitul Maal* and *Baitul Tamwil* were adopted to define the IIMFI. In this sense, the followers of NU have integrated the concept of *Baitul Maal* and *Baitul Tamwil* into *Baitul Maal wat Tamwil,* while those of *Muhammadiyah* utilise *Baitul Tamwil Muhammadiyah*. In this sense, *NU* and *Muhammadiyah* differ in their interpretation of both concepts. *Muhammadiyah* insists that integrating *Baitul Maal* and *Baitul Tamwil* is inappropriate from a *shari'ah* perspective, since the funds from *Baitul Maal* are supposed to be utilised for social activities, while the motive of IMFIs is purely business. Therefore, *Muhammadiyah* adopt the concept of *Baitul Tamwil,* which means more business mission for their IMFIs.

On the other hand, the NU argues that it is permissible for the funds from the *Baitul Maal* to be utilised for productive activities such as loans. In practice, despite integrating the concept of *Baitul Maal* and *Baitul Tamwil,* BMT does not utilise *zakah* for the source of funds. They mobilise savings from the local community as well as loan repayments from borrowers (Sirojudin & Midgley, 2011). This is because Indonesia's government regulates that only authorised and registered *zakah* administrations are allowed to collect and distribute *zakah* from/to the community. For this reason, BMT and BTM are similar, as both of them do not rely on *zakah* for the source of funds.

Statistically, Seibel and Agung (2005) estimate that the majority, or approximately 95% of IIMFIs are considered as BMT, while the remaining of 5% are considered as BTM. However, in practice, NU as an organisation has not played an active role in establishing, supervising or guiding BMT. The BMT was established by a community of NU followers and hence, the BMT's accountability is to its community.

In contrast, BTMs were legally possessed by the *Muhammadiyah* office at the district level, hence the BTMs' accountability is to the *Muhammadiyah* organisation as the owner. The establishment of BTMs was also guided and monitored by the *Pusat*

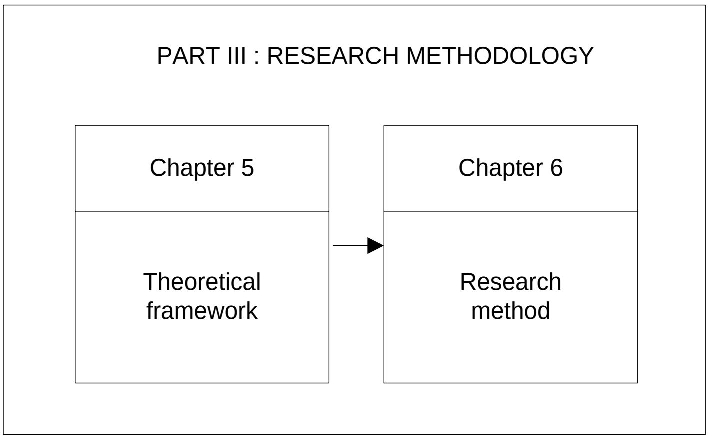
Pengembangan Ekonomi Muhammadiyah (Economic Development Centre of *Muhammadiyah*). This implies that there were different approaches to administering the IMFIs, which is the focus of this study and will be elaborated in the following chapters.

4.6. Summary and conclusion

This chapter provided the context of this research by briefly explaining the socio-economic and political background of Indonesia that led to the discussion of one of the main problems encountered by any developing country, poverty. As the most populous Muslim country in the word, Indonesia is heterogonous in terms of religious practice, which is itself represented by the two biggest Islamic organisations: NU and *Muhammadiyah*. From the outset, the ideological perspectives underpinning NU and *Muhammadiyah* were different, which resulted in a difference in worldview, beliefs and the practice of daily rituals. While the two organisations had their differences in interpreting and practising Islam, the roles of both have inevitably been and continue to shape society and promote social welfare throughout the history of Indonesia. Understanding the country's socio-economic and political context, particularly the differences between the ideologies of *Muhammadiyah* and NU, help in understanding the history and socio-economic background of the two IIMFIs that have been selected for this study.

PART III: RESEARCH METHODOLOGY

This part of the study presents the research methodology. Chapter 5 discusses the theory adopted for this study. This theory is used to build a theoretical framework that guides in achieving the research objectives of this study as stated in Chapter 1. Chapter 6 presents the research method and design applied in this study to achieve the research objectives of this thesis.



CHAPTER 5 THEORETICAL FRAMEWORK

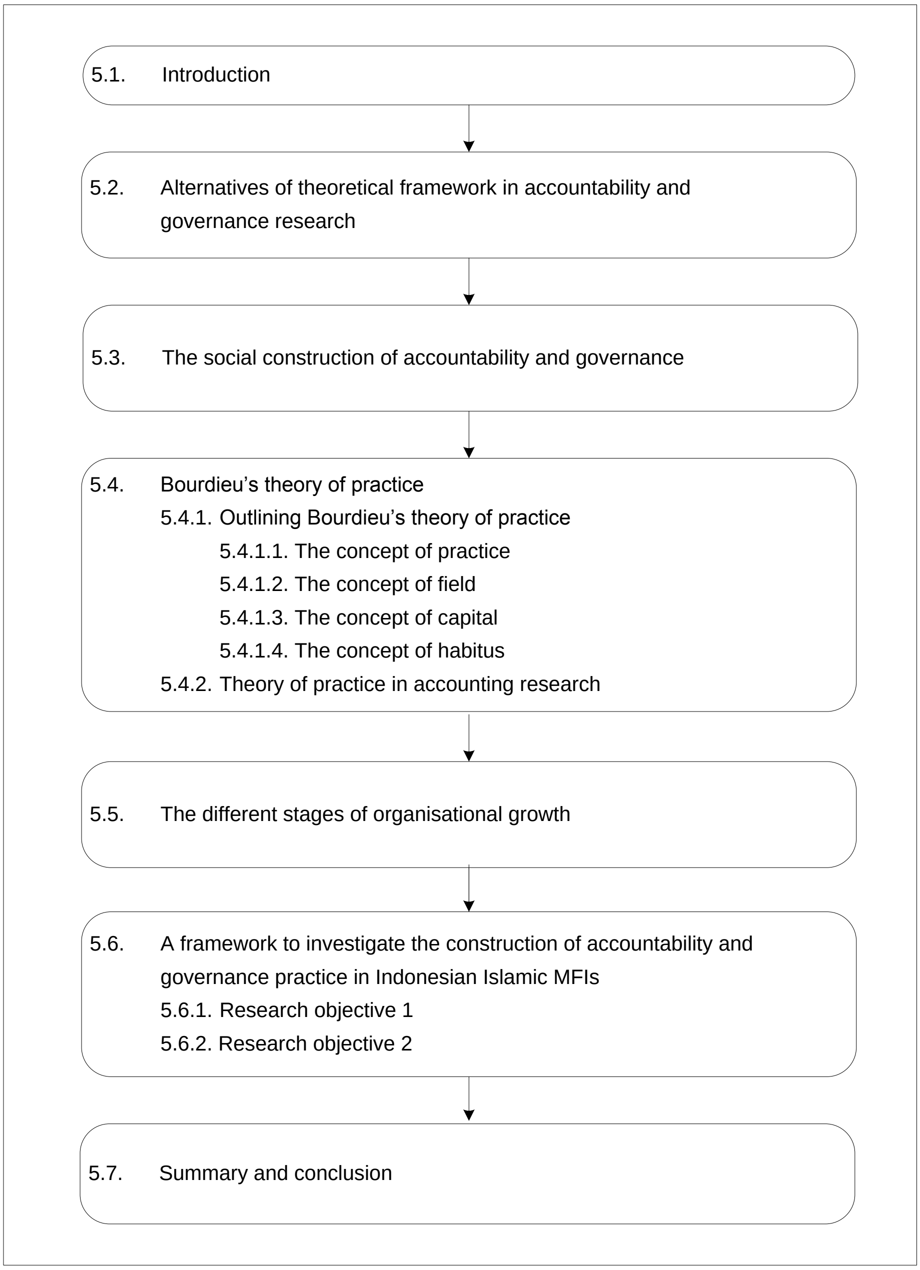
5.1. Introduction

This chapter aims to present the theoretical framework adopted to guide in achieving the research objectives of this study, which involves examining the historical development of IMFIs in Indonesia and investigating how accountability and governance practices have developed in the selected IMFIs.

As discussed in Chapter 2, the concepts of accountability and governance are dynamic and socially constructed, so their practice in organisations must therefore be understood from the specific context in which they are practised (Laughlin, 1990). However, as explained in Chapter 3, studies on accountability and governance in the context of MFIs predominantly explain the various accountability mechanisms and examine the relationships between governance and performance. Most of those studies are guided by the prominent theories of governance: agency theory, stewardship theory or stakeholder theory. Yet, these traditional theories are unable to explain how the practice of accountability and governance has developed in a particular sector and/or organisations. Therefore, this study adopts the theory of practice by Pierre Bourdieu as it is suitable in understanding the development of the *field* of IMFIs and how this affected the *practice*.

This chapter begins by discussing alternatives of theoretical framework within accountability and governance researches. Tha traditional theories of accountability and governance are unable to cover the dynamic aspects of such practices. Thus, the second part of this chapter explains the social construction of accountability, then followed by explanation of Bourdieu’s theory of practice, the key concepts of the theory and the adoption of such theory in prior accounting research. In order to understand how accountability and governance *practices* change over the period, section 5.5. discusses the different stages of organisational growth. It follows by the next part to elaborate a framework to investigate the constructions of accountability and governance within the context of IMFIs in Indonesia. Figure 5-1 illustrates the structure of the chapter.

Figure 5-1 The structure of chapter 5



5.2. Alternatives of theoretical framework of accountability and governance researches

A theoretical framework is " a collection of concept, concept of maps, and/or conceptual model that depict a piece of theory that is to be examined.." (Houser, 2012:141). Theoretical framework provides a relationship between variables and can be used to set the scope of research as well as help the researcher to analyse and interpret data. Literature on accountability and governance practices adopts different theoretical frameworks (Brennan & Solomon, 2008). Traditionally, agency theory which focused on the conflict of interest between principal-agent has been widely adopted (Eisenhardt, 1989). Then, stakeholder theory was introduced to broaden the scope of accountability and governance by accommodating the interests of other stakeholders such as customers, suppliers and government's bodies (Tricker, 2009a). While agency theory and stewardship theory has been succesfull to explain the relationship between agent and stakeholders, it failed to address the question on how accountability and governance practices are established (Huse, 2005).

As discussed in Section 2.5, accountability and governance practices are dynamic rather than static. Both concepts encompass social and contractual relationship between corporation and stakeholders (Ruhanen, Scott, Ritchie & Tkaczynski, 2010) and it involves an interactive and continuous process of account-giving (Jepson, 2005). Therefore, social and contextual factors matter in establishing the practice of accountability and governance (Overall, Tapsell & Woods, 2010). The practices are influences by social values, norms, traditions, beliefs and rules (Skelcher, Mathur & Smith, 2005). This suggests that accountability and governance practices can not be understood from the relationsip perspective as the focus of agency theory and stakeholder theory. It is socially, subjectively and continually being constructed within the organisation (Yakel, 2001; Abdul-Rahman & Goddard, 2003). Therefore, the next section discusses the social construction of accountability and governance.

5.3. The social construction of accountability and governance

The idea of 'social construction of what' (Hacking, 1999) has been posited in many disciplines. It assumes that entities such as reality, knowledge, facts, text and thought are shaped by cultural processes through which such entities are perceived and given meaning (Bruffe, 1986; Newman, 2004). Anything worth calling construction was or is constructed in quite definitive stages, where the later stages are built upon, or out of, the product of earlier stage. Anything worth calling construction has a history, but not just any history. It has to be a history of building (Hacking, 1999:50).

The concept of social construction effectively explains the argument that accountability has a historical aspect, that it was framed in cultural and historical ways. "The frameworks of accountability are not restricted to formal accountability system, such as annual statement" (Willmott, 2012:23). Accountability, in a general sense, can be seen as "any setting [that] organizes its activities to make its properties as on organized environment of practical activities detectable, countable, recordable, reportable, tell-a-story-about-able, analyzable – in short accountable" (Garfinkel, 1967:33). Therefore accountability also encompasses informal giving as part of everyday conversation that aims at "making the invisible visible" (Munro, 2012:5).

A number of accounting studies support the argument that accountability and governance are socially constructed (Jackson & Carter, 1995; Sinclair, 1995; Thurnbull, 1997; Yakel, 2001; Abdul-Rahman & Goddard, 2003; Ebrahim, 2003b). Accountability and governance are dynamic and influenced by values, social behaviours and beliefs. The literature debates whether accountability and governance should be established through internal or external systems. On one hand, researchers believe that professional standards, technical knowledge and individual values are becoming internal system construct accountability. On the other hand, researchers argue that external systems such as cultural, political, socio-environmental, and regulatory and oversight authorities will have more power to enforce accountability within organisations (Yakel, 2001; Al-Habil, 2011). However, Yakel (2001) argues that the construction of accountability and governance can be through both internal and external systems.

There is limited research examining how accountability and governance are constructed, enacted and developed in a specific spatial and social setting, with few exceptions (Reve & Levitt, 1984; Yakel, 2001; Newman, 2004). Reve and Levitt (1984) used a transaction-cost analysis to examine how governance was constructed within a construction project that involve three parties: a client, an engineering consultant and contractors. They argued that governance structure was enacted through a contract project. The contract acts as a governing construction transaction because it has substance rights and obligations relating to all parties involved. The contract also regulates mechanisms to supervise and monitor the progress of construction and to evaluate whether it has met the necessary requirements.

Another study was conducted to understand construction accountability in a specific setting. Adopting a case study approach, Yakel (2001) observed the creation of radiological reports within the hospital's department of radiology. Yakel (2001) concluded that accountability is constructed through both controlling the process of creating reports and establishing the content of reports, which is reflected in record-keeping practices.

Newman (2004) explored how accountability was constructed in a public sector that recently adopted a new form of governance known as 'New Public Management'. This reform requires public sector institutions to shift their management practices and techniques from embodying a traditional bureaucratic ethos to adopting a managerial regime, through decentralising the management of public services, among other things. As a result, network governance, in which responsibility in establishing policy and delivering services are shared across organisational boundaries, becomes significant. Newman (2004) examined the implication of the shift to accountability by tracing the construction of accountability within multi-agency working. The research concluded that when a new regulatory mechanism was being introduced, the actors were simultaneously constructing practical concepts of accountability as a guide for their decision-making process.

Research on the social construction of accountability suggests that understanding accountability requires an examination of the entire accountability environment, including social, historical and organisational contexts (Yakel, 2001). This study has considered a number of possible theories that underpin the theoretical frame. Firstly, the classic work of social constructionist proposed by Berger and Luckman (1967). This theory argues that human beings together create and maintain social phenomena through social processes. During social interaction, human beings share knowledge and establish a mutual agreement on the ‘way of doing things’. Therefore, language has an important role to play. However, since this study focuses on the practice rather than knowledge and language, hence social construction theory is considered less appropriate than Bourdieu’s theory as an theoretical basis for this thesis.

Secondly, Travelling Theory, put forward by Edward W. Said (1983) states that like people, ideas or theories can travel – from person to person, from situation to situation, and from one period to another. Therefore, travelling theory is useful to help in understanding what happens to people, ideas and cultures when they move across and between various socio-economic and political settings (Mandaville, 2006). As discussed in Section 3.2.2., IMFIs has been developed uniquely across the world from Syria, Pakistan and Malaysia (Imady & Seibel, 2003; Amanah Ikhtiar Malaysia, 2010; Akhter, Akhtar & Jafri, 2011), as well as Indonesia (Seibel, 2005a). While Islamic MFIs in other countries emerged to meet the demand for interest-free financial institutions (Karim, Tarazi & Reille, 2008), Islamic MFIs in Indonesia evolved mainly in response to political demand from Indonesian Islamic scholars (Seibel, 2008). Hence, Travelling Theory seems unfit to be adopted in this research.

Thirdly, the concept of ‘governmentality’ by Foucault which is defined as ‘conduct of conduct’ (Dean, 1999). It refers to any rational effort to influence or guide the conduct of a human being through acting upon their hopes, desire, environment and circumstances. It also ranges from ‘governing the self’ to ‘governing others’ (Lemke, 2000). The central notion of ‘govermentality’ is the way ‘technologies of government’ to facilitate the action of ruling at a distance (Neu, 2000). Thus, it assumes that the governing technology is used to shape, normalize the conduct, thoughts and decisions in achieving the goals they consider desirable (Neu, 2000). In this study, accountability and governance practices such as technology have not been established. Such practices are continually and socially contructed over the period. Therefore, this concept is considered not applicable for this study.

This suggests seeking an appropriate theory that helps to guide achieving research objectives and research questions for this study. Therefore, Pierre Bourdieu theory has been selected as most appropriate approach to understand how the development of the *field* of IMFIs and how this affected the *practice* within selected IIMFIs. This theory is discussed in the next section.

5.4. Bourdieu's theory of practice

Pierre Bourdieu (1930-2002) was a French philosopher, who also focused on sociology and ethnography following military service in Algeria during the war for independence against French colonialist in the late 1950s (Wacquant, 2004). Later, he taught at the University of Algiers and published a number of books addressing the Algerian situation. Returning from Algeria in 1960s he continued his career in academia and founded the *Centre de Sociologie Européeanne* which focused on three areas : education, art and culture and methodology (Grenfell, 2008a). After became the editor of *Le Sens Common* which published translations of prominent academic texts in the social sciences, he published a number of books in the 1980s which is recognised as his prolific output (Grenfell, 2008a). He also was involved in politics when he joined a committee to review the French curriculum and when he published personal account of French's social suffering during the economic policy adopted by the Socialist government (Grenfell, 2008a). For Bourdieu, the practical problems and issues surrounded his life has been impacted on his way of thinking which is called ‘auto-socio analysis’(Grenfell, 2008a). His socio-historical position influenced his intellectual trajectory into politics, economics, media, art, law, language, education, religion, painting as well as gender politics (Grenfell, 2008b). During his academic life, he developed key sociological concepts such as field, habitus and cultural capital which is the basis to understanding his theory of practice.

5.4.1. Outlining Bourdieu’s theory of practice

The genesis of the theory of practice emerged, in Bourdieu’s words, as follows: “All my thinking started from this point: how can behaviour be regulated without being the product of obedience to rules?” (Bourdieu, 1990a:65). He is concerned with understanding the interactions between people and social phenomena. He observes that individuals cannot be bounded to act in a particular way; hence he inquired how individuals’ behaviour becomes regulated and governed by the ongoing construction of practice (Baird, 2011).

The theory of practice is considered to be the first theory that provides a tool to analyse actions governed by practical intelligibility, i.e. what it makes sense to do (Schatzki, 1987), as Bourdieu argues: “*practice* has a logic which is not that of the logician” (1990b:86). For Bourdieu, the idea of *practice* constitutes relational thinking between three conceptual apparatus – *field, capital* and *habitus* – which are composed into a general formula as follows: *practice = (capital x habitus) + field* (Bourdieu, 1984:101).

The equation indicates that “*practice* results from relation between one’s dispositions (*habitus*) and one’s position in a *field* (*capital*), within the current state of play on that social arena (*field*)" (Maton, 2008:51). So, *practices* are not merely and simply determined by one's *habitus*, but a result of the relations between one's current circumstances (*capital*) and *habitus*.

In an attempt to provide an understanding of his conception, Bourdieu uses the analogy of the game to explain the dynamic relationships of the three concepts (Mahar, Harker & Wilkes, 1990; Warde, 2004). The *field* of the game is a sphere of play for which there is an ordered universe within which everything happens. Joining the game requires the players to accept consciously or unconsciously the explicit and implicit rules of the game. In this sense, the players are required to possess a feel for the game or practical mastery of the logic of the game. Within the game, this competence is shared among the players in order to determine the mastery level in proportion to their competence. From Bourdieu's perspective, the mastery of the game and competence are analogous to a person's possession of *capital* and its *habitus*, respectively (Mahar, Harker & Wilkes, 1990).

Bourdieu emphasises that those concepts are interrelated, both conceptually and empirically (Bourdieu & Wacquant, 1992), none of them dominant, causal or primary (Thomson, 2008), thus suggesting that the master concepts should be incorporated into one single study. The Bourdeusian concepts will be discussed in the following sections.

5.4.1.1. The concept of *practice*

A dictionary of critical theory defines practice as "a code in cultural studies for what people do in the course of their everyday life" (Buchanan, 2010:383). The term turn into a focus for cultural studies since people recognise what people do due to various activities that are recordable and observable, but people cannot know why or what they do because their purposes and intentions are invisible.

Bourdieu started thinking of a model of social practice from the perspective that every group, every culture and every society has their own theory about their world: how the world should be, how the world is, human nature and cosmology (Jenkins, 2003). For Bourdieu, the term '*practice*' has several distinctive features (Jenkins, 2003). First, *practice* is conducted in space and in time. It is something that can be observed noticeably from moment to moment.

Secondly, *practice* is not entirely unconsciously orchestrated or organised. "Nothing is random or purely accidental but, as one thing follows on from another, practice happens" (Jenkins, 2003:70). *Practice* is the product of an ongoing process of learning, neither entirely conscious nor unconscious, which begins in early childhood by taking part in social activities, through which actors know without knowing about the right thing to do (Bourdieu, 1990a). For Bourdieu, *practice* that is not governed by logically derived decisions is considered as an experimental system (Polkinghorne, 1997).

Thirdly, other characteristics of *practice* are fluidity and indeterminacy. Social life is complex and cannot be accomplished on the basis of a normative model, particular recipe or adherence to specific rules. Thus, it is impossible that *practice* has a rule or prescription for every situation, as *practice* always provides a space for actors to improvise their way. Accordingly, *practice* is not a product of rigid or structural rules, but instead it is the result of the actors' strategies to accomplish their goals; therefore *practice* has a purpose.

5.4.1.2. The concept of *field*

The term '*field*' was first employed by Bourdieu in the article entitled "*Champ intellectual et project créateur*". *Field*, or *le champ*, is a term used to describe an area of land, a *field* of knowledge and battle *field* (Thomson, 2008). Bourdieu uses the term '*field*' as a spatial metaphor in sociology, which is defined as:

> *"a network or configuration, of objective relations between positions. These positions are objectively defined, in their existence and in the determinations they impose upon their occupants, agents or institutions, by their present and potential situation (situs) in the structure of the distribution of species of power (or capital) whose possession command access to the specific profit that are at stake in the field, as well as by their objective relation to other position." (Bourdieu & Wacquant, 1992:97)*

Put simply, a *field* is a kind of social area in which, simultaneously, there is a space of competition and conflict; within the *field*s, a struggle takes place for accumulation of resource value (Bourdieu & Wacquant, 1992). Therefore, each social practice should be understood as a *field* of struggle or a competitive game wherein the agent imposes certain strategies to maintain or enhance their position in the *field* (Maton, 2008). For Bourdieu, the social life consists of various social *fields* such as religion, education, bureaucratic and political, and each *field* has its own regular, patterned and predictable practices, as well as its own history, rules, lore and distinctive logic of practice (Thomson, 2008). Bourdieu utilises the term '*field*' in order to broaden the range of possible factors that shape behaviour rather than confining behaviour to areas of activities (Swartz, 1997).

5.4.1.3. The concept of *capital*

Capital is accumulated labour, in both material forms and embodied forms (Bourdieu, 1986). For Bourdieu, *capital* is generalised resources involving different forms of *capital*, which can be monetary or non-monetary, as well as tangible or intangible (Bourdieu, 1986). He addresses different types of *capital*, as follows:

1. *Economic capital*

   Economic capital is a form of capital, such as financial resources, income and other assets, that is immediately and directly converted into money (Bourdieu, 1986) and finds its institutional expression in property rights (Anheir, Gerhards & Romo, 1995). *Economic capital* is considered to be the root of other capital as it is more significant than other forms of capital when it comes to obtaining essential resources within the competitive social arena (Silva & Edward, 2004). An empirical investigation into American society indicates *economic capital* to be fundamental for social power (Bourdieu, 1987), thus supporting the notion that position of agents in the social space is largely determined by the possession of *economic capital*.

2. *Cultural capital*

   For Bourdieu, *cultural capital* can be manifested in three forms: the embodied state, the objectified state and the institutionalised state (Bourdieu, 1986). First, *cultural capital* in the embodied state involves the form of a long-lasting disposition of the body and mind. It refers to the “ensemble of cultivated dispositions that are internalized by the individual through socialization and that constitute schemes of appreciation and understanding” (Swartz, 1997:76).

Most *cultural capital* characteristics in the embodied state are associated to the body and presuppose embodiment; thus the accumulation of *capital* starts from early childhood and occurs during a process of embodiment viz. in the form of culture, education and cultivation. Secondly, *cultural capital* in the objectified state refers to object in the form of cultural goods, such as painting, writing, monuments and works of art, all of which require the viewer to possess certain cultural abilities in order to be able to engage with them (Bourdieu, 1986). Thirdly, *cultural capital* in the institutionalised state refers to the educational credential system (Swartz, 1997). Unlike *economic capital*, *cultural capital* is not stable or universal. The process accumulation of *cultural capital* can be undermined by suspicion and criticism, which causes it to be unstable. Moreover, while *economic capital* can be transmitted inter-generation (i.e. from the family to the individual), *cultural capital* is not negotiable. In short, managing *economic capital* is easier than managing *cultural capital*, as the former can be conserved, transmitted and calculated.

3. *Social capital*

   Social capital is "the aggregate of the actual or potential resources which are linked to the possession of a durable network of more or less institutionalized relationship of mutual acquaintance or recognition" (Portes, 1998:5), or in other words, it is the membership to a group (Bourdieu, 1986). *Social capital* is intangible by nature and is related to the structure of relationships. Thus, to possess *social capital*, a person must be related to others. This is because *social capital* is not given naturally, thus it must be established through implementing strategies that are oriented towards the institutionalisation of its relation, as well as the usability and reliability of other benefits (Portes, 1998).

Being a member of a particular group enables the agent to possess the backing for collectively-owned *capital*, as well as obtain a credential that entitles the agent to receive credit (Bourdieu, 1986). Hence, Bourdieu breaks down *social capital* into two elements: first, the social relationship, which enables members to claim access to the utilisation of the resources possessed by the group, and second, the quality and amount of those resources (Portes, 1998).

4. *Symbolic capital*

   It is defined as "*capital* – in whatever form – insofar as it is represented, i.e., apprehended symbolically, in a relationship of knowledge or, more precisely, of misrecognition and recognition" (Bourdieu, 1986:56). Thus, the *symbolic capital* is essentially a transformed or disguised form of physical and *economic capital* (Bourdieu, 1977).

   For Bourdieu, *symbolic capital* is the negation of *economic capital*; it is not perceived as a power but a legitimate form of defence, recognition, service to others and obedience. The concept of *symbolic capital* is still relevant and applicable to contemporary societies since business requires some honorific justification for its operations (Swartz, 1997).

As discussed previously, a *field* or social space is a dynamic and multi-dimensional space and should be seen as a battlefield in which a game moves toward accumulating *capital* (Jayasinghe & Wicramasinghe, 2011). The agents then exploit the different forms of *capital* in order to maintain or heighten their relative position in the *field*, which creates *capital* that becomes a "social relation to power" (Swartz, 1997:73). Hence, discovering the most powerful and efficient forms of *capital* is like having a hand of aces in a game of cards, which will bolster the player's superiority in that game (Bourdieu, 1987). The different types of *capital* are interrelated (Portes, 1998). The agents can optimise their *social capital* in order to obtain direct access to various types of economic resources such as subsidised loans, customers or investment opportunities. At the same time, *cultural capital* can be improved by establishing contacts with experts who embody *cultural capital*, or by affiliating with other institutions that present value credentials, which results in institutionalised *cultural capital* (Portes, 1998).

Furthermore, although it is not possible for all conversions in all situations to be equal, the various types of capital are also inter-convertable (Swartz, 1997). In most cases, economic capital can be converted easily into *cultural* and *social capital*, but not vice versa. Most goods and services can directly and immediately be acquired by *economic capital*, but in particular situations, services and goods are available through *cultural* or *social capital*. Thus, whilst culture and social network are considered as *capital*, the footing is not equal with money and property of economic capital. This is because each capital embodies their own dynamics relative to economic exchange (Portes, 1998). It implies that the conversion of *social capital* into *economic capital* is more contingent and costlier.

On the other hand, the investments in both cultural and economic resources are required for the acquisition of *social capital*. However, the possession of *cultural* or *social capital* cannot be reduced easily into *economic capital*. Many transactions involving *social capital* are characterised by more uncertainty and less transparency such as uncertain time horizons or unspecific obligations (Anheir, Gerhards & Romo, 1995). Furthermore, despite *cultural capital* and *social capital* being relatively close, the convertibility of *cultural capital* into *social capital* is easier than vice versa (Anheir, Gerhards & Romo, 1995).

Since the characteristics of each position in the *field* are typical, the different features, liquidity and convertibility of various *capital* are utilised as a basis of acquiring strategies in order to ensure the reproduction of *capital* and the desire to occupy a certain position in the *field* (Bourdieu, 1986; Anheir, Gerhards & Romo, 1995). The following section discusses the central concept of Bourdieu's theory of practice: *habitus*.

5.4.1.4. The concept of *habitus*

Habitus is Bourdieu's central and indispensable concept in apprehending social actions or practices (Fee & Macintosh, 2008). *Habitus* is defined as a "system of durable, transposable dispositions, structured structures predisposed to function as structuring structures, that is as principle which generate and organize practices" (Bourdieu, 1990b:53). A notion very often associated to *habitus* is habit, which helps to explain social construction (Maton, 2008). However, Bourdieu confirms the distinction as follows: "I said habitus so as not to say habit" (Bourdieu & Wacquant, 1992:122). The key difference between habit and *habitus* is that habit has a connotation of the mechanical action – repetitive, reproductive, instead of productive and automatic (Bourdieu, 1995; Goddard, 2004), whilst *habitus* underlines the primary structure of practice, i.e. acts are underpinned by a generative principle (Maton, 2008).

From the above definition of the term "*habitus*", three central features of habitus can be identified. First, *habitus* is "structure", which means that it is ordered in a systematic way rather than an un-patterned or random one (Maton, 2008). This structure encompasses the system of disposition, which induces appreciation, perception and practice (Bourdieu, 1990b). Hence, *habitus* comprises two essential components – structure and propensity – which incline people to act and react in particular ways (Swartz, 1997). Bourdieu explains that the word "disposition" is appropriate to convey what is covered by the concept of *habitus*:

> *It expresses first the result of an organizing action, with a meaning close to that of words such as structure; it also designated a way of being, a habitual state (especially for body) and, in particular, a predisposition, tendency, propensity or inclination (Bourdieu, 1977:214)*

These dispositions are durable and they last over time. Bourdieu highlights that "the habitus [...] is that which one has acquired, but which has become durably incorporated in the body in the form of permanent disposition" (Maton, 2008:56). Thus, *habitus* refers to something that links to individual history and belongs to a genetic mode of thought. Thus *habitus* can imply something like property or capital (Maton, 2008). Furthermore, disposition is also transposable, which means that *habitus* is a power of adaptation (Bourdieu, 1995) in becoming active within a variety of social structures (Maton, 2008).

Secondly, *habitus* as 'structured structure' implies that *habitus* is learned, encoded and socialised into the individual from early childhood, thus shaping individual actions (Baird, 2011). *Habitus* is a result of the socialisation of past family experience, background and education, all of which are present in internal or external structures, which leads individuals to behave unconsciously (Jayasinghe & Wicramasinghe, 2011).

Thirdly, *habitus* as ’structuring structure‘ means that *habitus* specifies present and future individual behaviours when it comes to conducting a certain practice (Jayasinghe & Wicramasinghe, 2011). The existing social condition of individual lives such as family upbringing and educational experience predisposes directly or indirectly on *habitus*, thus influencing the conduct of individuals and imposing certain practices.

In short, *habitus* is the concept that is imperative to understanding how and why individuals produce certain practices beyond the boundaries of structures, thus distinguishing *habitus* from overt rules such as laws or regulations when it comes to governing individuals’ behaviours (Baird, 2011). *Habitus* refers to the unconscious ways people act and react, focusing on their ways of being, thinking, feeling and acting (Maton, 2008), encompassing both structured past structure (*opus operatum*) and structuring present structure (*modus operandi*); thus it is open to objectification and then in generating all the common-sense, rational behaviour, thought and actions (Bourdieu, 1977, 1992; Grenfell, 2008c). Hence, *habitus* is the link between past, present and future actions. However, as *habitus* is derived from primary socialisation since childhood, it is almost resistant to change. It does not, however, mean that *habitus* is immutable (Maton, 2008) – there is indeed the possibility for ongoing adaptation of it – yet the process tends to be unconscious, slow and merely elaborates new situations, rather than making changes to the fundamental disposition (Swartz, 1997).

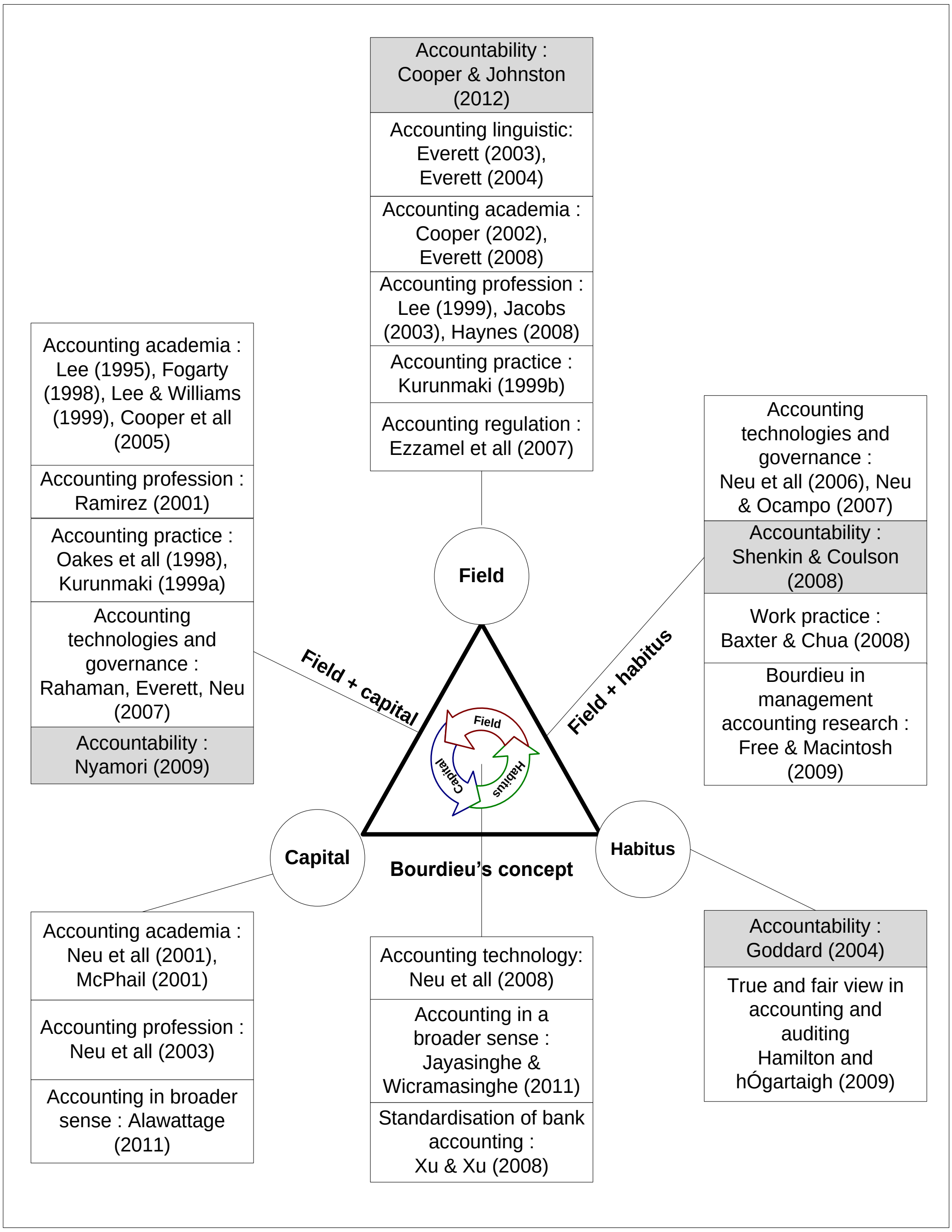
5.4.2. Bourdieu's theory of practice in accounting research

Accounting research is interdisciplinary (Merchant, 2008). Studies in accounting have drawn on the theory, philosophy and methodology from other social science disciplines such as economics, philosophy, history, and sociology (Chua, 1988). Theories in social science play an important role to enable the expression of meaning and significance of the social phenomena (Llewelyn, 2003). Hence, adopting a particular theory in a piece of research will enable data to become more meaningful.

The adoption of Bourdieu's concepts in accounting research has flourished in key journals relating to interpretive and critical accounting (Malsch, Gendron & Grazzini, 2011). The map of accounting research that have adopted Bourdieu's conception is illustrated in Figure 5-2.

At the onset, the adoption of Bourdieu's theory in accounting research focused mainly on accounting education or academia. In its later development, Bourdieu's concept was translated into a wide range of accounting research areas including accounting and linguistics (Everett, 2003, 2004), accounting technologies and governance (Neu, Gomez, Graham & Heincke, 2006; Neu & Ocampo, 2007; Rahaman, Everett & Neu, 2007; Neu, Silva & Gomez, 2008), application of accounting in a broader sense (Alawattage, 2011; Jayasinghe & Wicramasinghe, 2011), the impact of socio-political situations to accounting systems (Ezzamel, Xiao & Pan, 2007), accounting behaviour (Baxter & Chua, 2008), standardisation of accounting classification and terminology (Xu & Xu, 2008), and auditing (Hamilton & hÓgartaigh, 2009).

Figure 5-2 Mapping the adoption of Bourdieu's triad in accounting research



Source: Author

In accounting literature, Bourdieu's concepts of *field*, capital and *habitus* has adopted individually, entirely or incorporates two out of the three i.e. *field and* capital or *field and habitus*. In particular, Bourdieu's concepts are considered to hold substantial implications for academics in the area relating to accountability (Shenkin & Coulson, 2007), as the discourses of accountability relate not only to the field of business studies, but also to politics, anthropology, education, organisational theory and media studies.

Among Bourdieusian concepts, the concept of *field* and *habitus* are deemed as being imperative tools that provide significant insights to the study of accountability for two main reasons (Shenkin & Coulson, 2007). Firstly, the practice of accountability can transpire in multi-dimensional spaces within diverse types of *field*, which results in the various modes in the production of accountability. Secondly, the practice that relates to the production of accountability can be construed as politicised activity, since in the real-world, socio-political situations can affect the *practice* and accountability.

As a result, some scholars borrow Bourdieu's concepts in researching accountability (Goddard, 2004; Nyamori, 2009; Cooper & Johnston, 2012). Goddard (2004) conducted a study in four local governments in the UK in order to examine the relationship between the budget process and the perception of accountability. Goddard (2004) found a variation in the perception of accountability and budgetary practices among respondents, and therefore proposed a grounded theory of relationship based on those case studies in order to reveal the differences in practices. The concept of *habitus* aided in explaining the construction of perceptions toward accountability, and how such perceptions affect the divergence in the budget preparation.

Using the other concept of Bourdieu's: *field and capital*, Nyamori (2009) evaluates the system of accounting and accountability for the Constituency Development Fund

(CDF) in Kenya based on newspaper articles and the literature. He found that those systems are inclined toward needing centralised national planning and development rather than encouraging citizens' participation in development.

The concept of *field* was adopted by Cooper and Johnston (2012) in critically examining the notion of accountability within the sport of football. This sport represents an interesting arena for studying accountability due to the quest of enthusiastic and active fans to discover information related to any aspect of their football clubs. Using a case study of the hostile takeover of Manchester United Football Club by the Glazer family, they concluded that the need for accountability and transparency in football is derived from the passion of the club's fans and their insatiable demand for information about their team and its management.

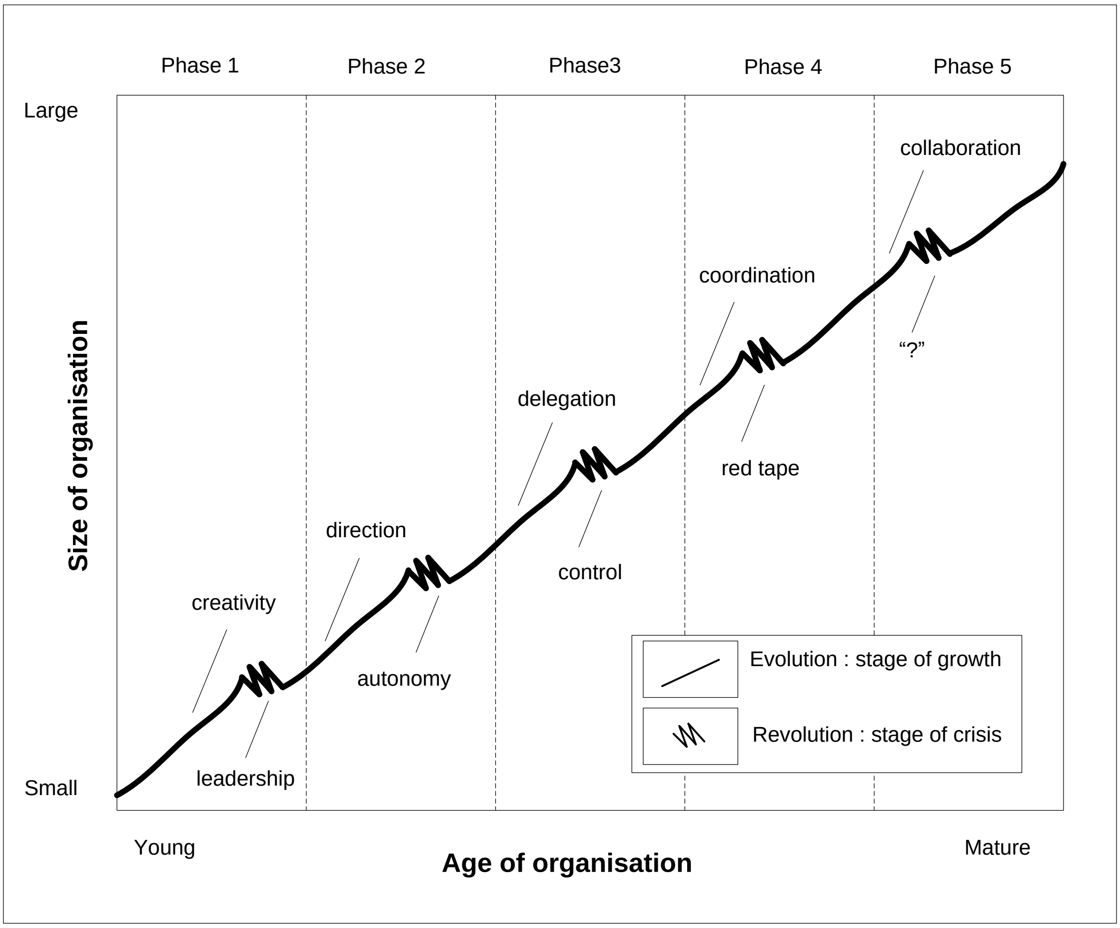
The review of the accounting literature above demonstrates that by bringing Bourdieu's concept into accounting research will help researchers to develop their insight and understanding of accounting as a *field* of *practice* (Malsch, Gendron & Grazzini, 2011). This study also draws on Bourdieu's concepts to seek the construction of accountability and governance practices within the context of IIMFIs. The construction of accountability and governance within organisations is a continuing process as organisations grow and change over time (G.Smith, Mitchell & Summer, 1985). Therefore, the next sections discuss the different stages of organisational growth.

5.5. The different stages of organisational growth

According to Greiner (1998), organisations grow and develop within two dimensions: age and size of organisation. The lifespan of the organisation is the most essential and obvious dimension of any model of organisational development, as no organisation can maintain the same practices throughout its lifetime. Another dimension of organisational development is the size of organisation. The complexities of organisational problems changed markedly in line with the increase in an organisation's activities and the number of people involved. Thus, this suggests that management problems are rooted in time and size.

A simple organisational structure may be applicable during the period when an organisation's activities are limited and involved only a few people. However, when an organisation grows in size, it needs to modify the organisational structure in order to improve control within its increasingly complex hierarchy. In other words, as new functions emerge, the management hierarchy multiplies, which causes coordination and communication problems to magnify. Moreover, during its development and growth, another phenomenon emerges: stage of growth (or stage of evolution) and stage of crisis (or stage of revolution) (Greiner, 1998). Stage of growth is described as a tranquil period because only simple adjustments are needed for maintaining its growth, while stage of crisis is a turbulent time period that is characterised by serious upheaval within management practices. During the revolution stage, the significant task for management is to seek and establish a new set of management practices as the basis for managing the transformation to the next evolutionary stage. Based on the dimensions of both age and size of the organisation, a model for organisational growth can be divided into five phases (Greiner, 1998), as illustrated in Figure 5-3.

Figure 5-3 The five phases of organisational growth



Source: Greiner (1998:5)

According to Greiner (1998) the stages of an organisation's growth act like a chain reaction, whereby one phase occurs as a result of the prior phase, and acts as the cause of the following phase. Moreover, in each stage, the manager has limited options in making decisions for growth to occur. For instance, when a company faces an autonomy crisis in phase two, the manager cannot maintain their directive management, but must instead adopt a new management style, e.g. delegation, in order to move to the next phase of growth. The characteristics of each phase are further described as follows:

a. *Phase 1: Creativity*

In this stage, the organisation's focus is to create both product and market. So, the founders are entrepreneurially or technically orientated, and they put their physical and mental efforts in developing and selling new products. Hence, they tend to relatively overlook management activities and the decision is driven by customers' reactions. The number of employees are often small and communication among members of the organisation occurs more frequently and informally. When the organisation grows, the number of products and services, as well as the number of employees, increases significantly. This requires specific knowledge to ensure efficiency in the operational process, better accounting procedures to control financial activities, and the establishment of better job divisions among employees. In this situation, a crisis in leadership may emerge, as the company needs a leader to help it solve any problems that may arise due to expansion.

b. *Phase 2: Direction*

After installing a capable business manager, organisations that survive will experience a period of sustained growth under directive leadership. Some characteristics of this period include the introduction of a functional organisational structure with separate organisational functions such as marketing, operations, and supporting departments such as accounting and human resources. When the organisational structure becomes clearer, the communication among employees becomes more formalised based on the hierarchy of the employees' positions within the organisation. A new directive helps to efficiently channel employees' energy into the organisational growth that is taking place. However, this leadership style is considered to be inappropriate to control more complex and diverse organisations. The decision made by the top-level management may be centralised, and lower-level employees are limited when it comes to creating and implementing initiatives. As a result, a crisis of autonomy starts to emerge and the solution to move forward requires delegating some responsibilities to middle and lower-level management.

c. *Phase 3: Delegation*

The organisational growth in this phase would have evolved from the implementation of a decentralised organisational structure. The organisational characteristic in this stage include greater responsibilities being transferred based on territorial market basis or profit centres whereby bonuses are given in order to motivate employees. Thus, top-level managers manage by exception, based on the periodic report from the business unit/profit centre. The advantage of this approach is that managers of a decentralised organisation are able to expand the markets, as they can respond promptly to their customers. However, this freedom brings the consequence of a parochial attitude, as the autonomous manager tends to run business on their own without coordinating plans, technology, money or personnel with head office. Soon, top-level management loses its control and the organisation enters into a crisis of control.

d. *Phase 4: Coordination*

The main characteristic of this phase is the utilisation of formal systems and procedures with the aim of achieving greater coordination. Top-level executives take the responsibility to initiate a new administration system, such as consolidating decentralised units to become product groups, treating each group as an investment centre, evaluating their performance based on the return on invested capital, and allocating funds based on performance achievements. On the other hand, the decentralised organisation retains its control over the technical functions. However, the consequence of this method is the lack of confidence between head office and the field, and between staff and line managers. Moreover, a bureaucratic system starts to evolve, whereby procedure takes precedence over problem solving. When an organisation becomes large, formal programs and rigid systems are insufficient for managing the complexity within the organisation.

e. *Phase 5: Collaboration*

The focus of the collaboration phase is solving problems promptly through team actions in order to handle specific tasks. Therefore, a matrix-type organisational structure is adopted in order to assemble the right team to solve appropriate problems. In this situation, meetings with key managers are conducted only if major problems arise. The spontaneity in management action is the main characteristic of the collaboration phase, which is guided by social control and self-discipline rather than formal control. Due to this nature, education and training are essential to equipping managers with the behavioural skills required to achieve better teamwork. In the collaboration phase, the crisis that may arise is related to the psychological saturation of employees following the heavy pressure of innovative demands as well as being physically and emotionally exhausted by the intensity of teamwork. The organisational practice of each phase can be summarised in Table 5-1.

Table 5-1 Organisational practices in the five phases of growth

Category	Phase 1	Phase 2	Phase 3	Phase 4	Phase 5
Management focus	Develop and sell	Efficiency of operations	Expansion of market	Consolidation of organisation	Problem solving and innovation
Organisa-tional structure	Informal	Centralised and functional	Decentralised and geographical	Line staff and product groups	Matrix of team
Top-management style	Individualistic and entrepreneurial	Directive	Delegative	Watchdog	Participative
Control system	Market result	Standards and cost centre	Report and profit centre	Plan and investment centre	Mutual goal setting

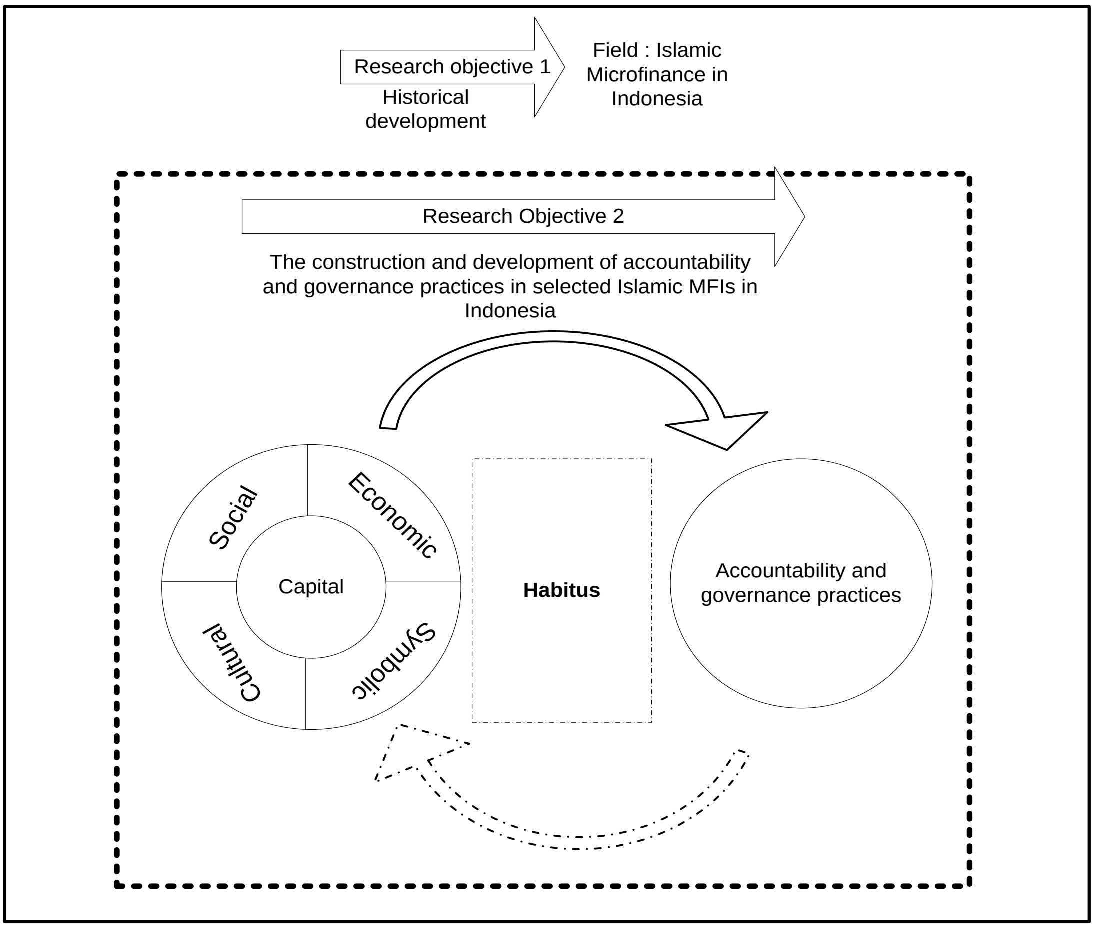
Source: Evolution and revolution as organisations grow (Greiner, 1998:10)

In brief, organisations encounter different challenges from one phase to another that require managers to alter organisational structure, business strategy, management styles and control systems as part of the accountability and governance process. The next section discusses how this study employs Bourdieu's theory of practice in order to establish a framework to address the research objectives of this study.

5.6. A framework to investigate the construction of accountability and governance practices in Indonesian IMFIs

Figure 5-4 illustrates an overview of the theoretical framework underpinning this research based on Bourdieu's theory of practice, as discussed in the beginning section of this chapter. This study follows Yakel's argument (2001) that the construction of accountability and governance can be established through external and internal systems. Therefore, there are two main boxes in the framework, representing the different levels of analysis. The outer box represents the boundary of this study, which analyses the *field* of the Islamic MFIs at the external level in order to address the first research objective. On the other hand, the inner box (dotted-box) analyses the players/agents at the internal (organisational) level in order to address the second research objective. This framework is further discussed based on each stated research objectives.

Figure 5-4 A conceptual framework to investigate how accountability and governance are developed and practised within selected cases of Islamic microfinance institutions in Indonesia



Source: Author

5.6.1. Research objective 1

As discussed in Chapter 2, the practice of accountability and governance varies across the profit, non-profit and social enterprise sectors. However, as discussed in Chapter 3, there are limited studies examining how accountability and governance are constructed within the micro-finance sector or institution, particularly Islamic micro-finance. Hence, this study attempts to fill the literature gap by investigating how accountability and governance are developed within IMFIs. Since historical and cultural context affects an institution's governance (Haniffa & Cooke, 2002; Tricker, 2009a) practices, it is important to understand the context within which the institution operates. Following this argument, the first research objective of this study is therefore to examine the historical development of IMFIs in Indonesia. Understanding the development of this sector will help us to understand how accountability and governance practices of IIMFIs change and develop over a period of time.

The IIMFIs has been evolving since the 1990s, and the development has been shaped by the dynamics of the Indonesian socio-economic and political conditions. Among the innumerable IIMFIs operating in this sector, some have ceased their operation, while many still continue to provide financial services for the low-income group in society. The dynamic nature of the IIMFIs is akin to the concept of *field* in Bourdieu's theory of practice, which is defined as a social and competitive arena in which the players struggle and adopt particular strategies to assign their position within the *field*. As Erickson (1996) argues, the basic interpretation of a *field* is an industry.

As mentioned by Bourdieu, a *field* is not simply a social location or specific group/organisation or population. A *field* is dynamic and it has its own logic, rules, characteristics and properties. Therefore, in order to investigate the distinctive characteristics of the *field*, it is vital to consider four intimate aspects of it: (1) the social history of the *field*, (2) the relationship of the *field* with other *field*s, (3) the specific struggle and stake that fuel the dynamics of the *field* and (4) the contemporary dynamic of the *field* (Kay & Laberge, 2002). Moreover, analysis of the *field* also requires an analysis of the social configuration, i.e. the economic and political situation in which the *field* is embedded (Emirbayer & Johson, 2008).

Islamic microfinance in Indonesia is a distinctive *field*. The specific characteristics of Islamic microfinance have been discussed in Chapter 3, of which the most prominent is that their operations must be based on *shari'ah* principles. Hence, in exploring the *field* of Islamic microfinance in Indonesia, it is important to trace the historical background of the establishment as well as analyse the socio-economic and political dynamics affecting the development of the *field*. .

5.6.2. Research objective 2

The second research objective seeks to investigate the way in which accountability and governance are developed and practised within selected IMFIs in Indonesia. As discussed in the previous sections, accountability and governance practices change over a period in order to follow the growth of an organisation in terms of age and size (Smith, Mitchell & Summer, 1985). During this growth, organisations encounter different challenges that require managers to shift their business strategies, organisational structures and control systems. As mentioned by Bourdieu, *practice* is the product of continuous learning process (Bourdieu, 1990b), governed by logical decision-making (Polkinghorne, 1997). Therefore, the adoption of Bourdieu's theory of practice will help in understanding how and why the practice of accountability and governance has changed and developed over time.

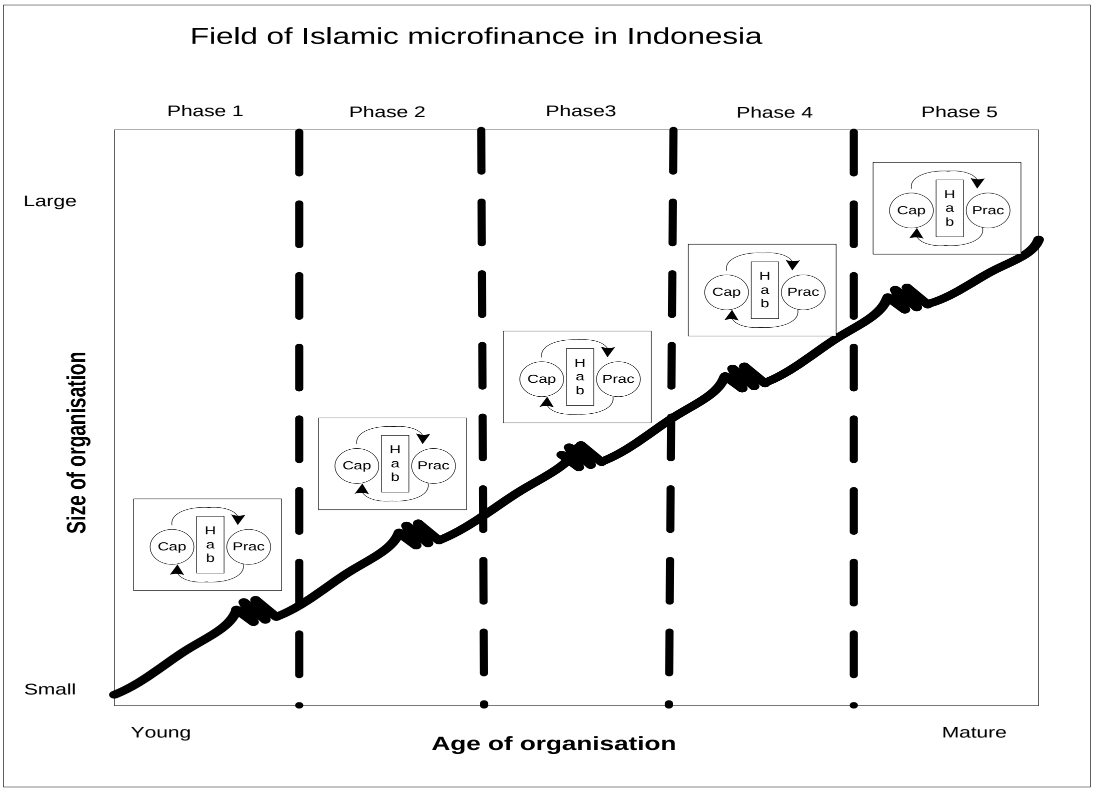
As suggested by Bourdieu, the three concepts of *field, capital* and *habitus* are interrelated. As a social arena, the *field* provides specific and eminent rules that should be followed by players. On the other hand, *capital* is deemed to be of value in the *field* because the position of the players in the *field* is determined by the magnitude of *capital* they possessed. Therefore, *capital* becomes a source of power that is used by the players to occupy a space in the *field*. Power relations among the players in the *field* are not static, but dynamic, as there is always a change both in the position of the player and the structure of the *field*. Players continuously compete and mobilise their *capital* in order to maintain or improve their position in the *field* by adopting particular practices that enable players to achieve the necessary goals. This relational thinking between *capital* and *practice* can be understood from the concept of *habitus*. *Habitus* works in two directions: it directly motivates players to generate certain *practices* and it subtly enables players to accumulate *capital* that will in turn affect their position in the *field*.

Based on this concept, an analysis of accountability and governance practices in this study will focus at the organisational level. Since the central observation of social construction is in the *habitus*, the analysis will start from the organisational habitus. Bourdieu suggests that *habitus* is the historicity of social structure and individual disposition (Bourdieu, 1977), and as such, identification of the *habitus* requires examining the social trajectories that could have possibly produced that *habitus* . Since the context of this research is IIMFIs, Islamic values, ethics, embodied faith and piety are therefore expected to be inculcated and embedded into the organisational *habitus*. This is because religion plays a significant role in shaping and forming behaviours, attitudes and outlooks, as “individual learns and internalize values within the context of religious system of belief and practice” (Brown, 1991:412).

While *habitus* plays an important role in shaping organisational behaviour, it is equally important to analyse organisational *capital* in order to understand the *practice* of accountability and governance within the organisation. As discussed in this chapter, Bourdieu classifies *capital* into four types: *economic, culture, social and symbolic*. While economic capital, such as money and properties, is universal, *culture, symbolic and social capitals* are specific and unique for every single organisation. Therefore, identification of the manifestation of the various *capitals* within the organisation is significant for two reasons. Firstly it helps in understanding the interrelations among the various *capitals* and the possibility for a certain *capital* to be converted into other types of *capital*, and secondly, it helps in identifying the most powerful types of *capital* that drive the change of accountability and governance *practices*.

In brief, the link between *capital, habitus and practice* within the context of IIMFIs can be summarised as follows. The *habitus*, which is largely influenced by Islamic values, affects IIMFIs especially in the administration of their *economic capital*, and in turn, their adoption of particular accountability and governance practices. By continuing to implement their particular practices, IIMFIs are able to improve their *symbolic capital* i.e. recognition by and trust from society, which will consequently increase their *economic capital*. Following this development, IIMFIs may experience complexity in administering the growth of their *economic capital* (asset) and *social capital* (network). As a consequence, IIMFIs, which are motivated by their *habitus*, are required to adjust their accountability and governance practices. This loop process of producing and reproducing practices steadily follows the different phases of organisational growth, as illustrated in Figure 5-5.

Figure 5-5 The development of accountability and governance practices



Source: Author

Furthermore, the relationship between *field* and *capital*, and *habitus* and *practice*, can be described as follows. The *field* of Islamic microfinance provide the rule, in this case the *shari'ah* principles that players or financial institutions should adhere to in their operations. At the organisational level, the rules based on *shari'ah* principles, guides the organisation to establish procedures in the offering of products and services and in its lending practices based on profit and loss sharing rather than interest, thus representing its *cultural capital*. On the other hand, the magnitude of *economic capital* acquired by the IIMFI determines its position in the *field*. There are numerous IIMFIs operating in Indonesia; those that have survived to the present day are competing to gain a specific position in the *field* –those that are able to develop their assets continue to experience growth while others remained stagnant or perish. The rules of the *field* subtly affect *habitus* and *practice* concomitantly. The rules will imbue *habitus* in guiding organisations' behaviour, generating practices in accordance to *shari'ah* principles. On the other hand, the collective *habitus* of players, such as the requirement of specific regulations for IMFIs and involvement of regulatory bodies that can help IMFIs to supervise and control their operations, may affect the landscape of the *field* of Islamic microfinance.

5.7. Summary and conclusion

This chapter discussed the theories and concepts that underpin this study and presented the framework (see Figure 5-4), which will help in exploring the construction of accountability and governance in IIMFIs. This chapter began by presenting Bourdieu's theory of practice and discussing its key concepts, followed by a review of the accounting literature of studies that have adopted the theory of practice. This chapter also re-emphasise the idea that accountability and governance practices are socially constructed, as discussed in Chapter 2.

The social construction of accountability and governance practices is an ongoing process and it follows organisational growth. Hence, this chapter discussed the various stages of organisational growth and the management process that occurs at each stage. Finally, this chapter described the theoretical framework which involved analysis at two levels: sector level, to address the first research objective, and organisational level, to address the second research objective. In short, understanding how accountability and governance are constructed within the organisation is considered as an attempt to understand accounting in the context in which it operates, as suggested by Hopwood (1983). The next chapter discusses the research method used for this study.

CHAPTER 6 RESEACH METHOD

6.1. Introduction

The previous chapter has presented the theoretical framework to aid in examining the construction of accountability and governance in IIMFIs. This chapter presents the research method adopted in this study to address the research questions, as well as outlining justification for the choice of methodological position of this research and the research design.

This chapter proceeds as follows. The next section briefly discusses the alternative methodologies in researching accountability and governance practices within MFIs. Section 6.3 presents the research design adopted to address the two research questions in this study. Section 6.4 presents the summary and conclusions. The structure for this chapter is illustrated in Figure 6-1.

Figure 6-1 The structure of chapter 6

6.1. Introduction

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6.2. Alternative methodologies in researching accountability and governance in microfinance institutions
- 6.2.1. Mainstream accounting research
- 6.2.2. Interpretive accounting research
- 6.2.3. Critical accounting research

↓

6.3. Research design
- 6.3.1. Examining the historical development of Islamic microfinance sector
  - 6.3.1.1. Data collection
  - 6.3.1.2. Interview
  - 6.3.1.3. Secondary resources
  - 6.3.1.4. Evaluation of the collected secondary material
  - 6.3.1.5. Data analysis
- 6.3.2. Investigating the construction and development of accountability and governance practices in selected IIMFIs
  - 6.3.2.1. Ethnographic research approach
  - 6.3.2.2. Data collection method
    - 6.3.2.2.1. Selecting setting and cases
    - 6.3.3.2.2. Getting access
    - 6.3.3.2.3. Interview
      - 6.3.3.2.3.1. The pilot interview
      - 6.3.3.2.3.2. The preparation prior interview
      - 6.3.3.2.3.3. The interview process
      - 6.3.3.2.3.4. Post interview
      - 6.3.3.2.3.5. Transcribing interview
    - 6.3.3.2.4. Observation
    - 6.3.3.2.5. Secondary data
  - 6.3.2.3. Reliability and validity data
  - 6.3.2.4. Data analysis

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6.4. Summary and conclusion

6.2. Alternative methodologies in researching accountability and governance in microfinance institutions

Accounting is an interdisciplinary subject (Merchant, 2008) and accounting researchers often draw theories as well as methodologies from other disciplines (Roslender & Dillard, 2003). In other words, the interdisciplinary of accounting research refers to the view of accounting through the lens of another discipline such as sociology, history, political science or psychology (Roslender & Dillard, 2003). Laughlin (1995) argues that theory and methodology dimensions are related. Moreover, as an academic discipline that has been engendered within a research community and has produced numerous studies, accounting scholars have rarely developed paradigms within an accounting perspective. Instead, accounting largely adopts the social science paradigm, thus accounting is viewed as a multi-paradigm science (Riahi-Belkaoui, 1996, 2004).

As a result, the wide range of empirical research in accounting adopts various paradigms, and theoretical and methodological approaches. Research in accountability and governance in microfinance institutions is no exception. Different assumptions about knowledge, epistemology and methodology have illuminated the ways to research accountability and governance issues, as offered by Chua (1986): mainstream, interpretive and critical paradigms, which will be discussed in the next section.

6.2.1. Mainstream accounting research

The term mainstream is defined as 'the ideas, attitudes or activities that are shared by most people and regarded as normal or conventional' (Stevenson, 2010). It refers to the prevailing thinking that is viewed as common by society and sometimes associated with the usual way of doing something. Mainstream accounting research has been dominated by the positivist paradigm (Locke & Lowe, 2008; Lukka, 2010), including research on accountability and governance in MFIs. Studies in this area mainly aim to examine the correlation between the various aspects of governance on financial performance, sustainability or outreach, while research on accountability is dominated by studies that analyse financial reports in achieving accountability for probity and legality. These studies employ a scientific method that is based on the belief of physical realism, which means that 'there is a world of reality that exists independently of human being' (Chua, 1986:606). In other words, realism is 'what we sense is reality' (Saunders, Lewis & Thornhill, 2012:136) and realism creates an obvious distinction between the object and the subject. The object (what is out there) is perceived independently from the subject (the knower), thus knowledge is acquired when a subject correctly reflects objective reality (Chua, 1986). Consequently, this methodology uses sophisticated statistical testing and a hypothetico-deductive model to verify the theory/hypothesis and to generalise the phenomena (Chua, 1986).

The most profound benefit of applying a mainstream accounting approach is its objectivity, as this method provides systematic, standard procedures and rigorous processes for conducting research. Hence, the causal relationship can be identified as a basis to establish generalisable knowledge (Ryan, Scapens & Theobald, 2002). However, the mainstream accounting approach is not without limitations. This approach is rigid, as it follows the scientific method, which is highly structured in selecting variables, in the data-gathering process as well as in analysing the data

(Ryan, Scapens & Theobald, 2002). It also tends to simplify complex phenomena into a tested model. Furthermore, it focuses mainly on the technical aspects of accounting and assumes that the existing social and environmental factors are taken as given (Chua, 1986). Whereas accountability and governance practices are dynamic, they may construct and be constructed through human interactions. Therefore, the mainstream approach tends to overlook the argument that accounting constitutes a social construction in which the social system highly influences the accounting practices in place (Dillard, 1991). Given the limitations of mainstream accounting research, some accounting scholars have started to adopt alternative paradigms: interpretive and critical.

6.2.2. Interpretive accounting research

The interpretive paradigm encompasses the sociological and philosophical thinking that views humans as an integral part of the social process and as actively involved within it (Burrell & Morgan, 1979). The statistical method's emphasis on the causal relationship is perceived as inappropriate to address human beings, their feelings and their minds, which are expressed in their actions.

An interpretive approach is derived from the philosophical stance of social science which attempt to understand, describe and interpret the meaning of human symbols, language and structures (Chua, 1986; Baker & Bettner, 1997). This approach was developed from several assumptions as follows. Firstly, in terms of belief about physical and social reality, an interpretive approach considers the world as not a natural phenomena, but as socially constructed rather than discovered (Lukka, 2010). Social science is concerned with particular meaningful behaviour or actions which are endowed with subjective meaning of the actors. Since the actions are always deliberate, they can not be understood without considering their meaning. Moreover, the focus of social science is not merely the action, but also the people who interact through social interaction (Chua, 1986) causing the meanings to be contextual (Brand, 2009).

Secondly, given that the social practice is subjectively created, it focuses on the day-to-day action (Roberts & Scapens, 1985) and exploration of how the social order is produced and reproduced and what the motives of doing certain actions are (Chua, 1986). The explanation of social action should be compatible with the criteria of logical consistency which requires objective validity of thought. The criteria of subjective interpretation, in which scientist seeks the meanings of actions and finally postulates the agreement of actors toward the explanation of their intention (Chua, 1986). Further, the precise procedures to conduct the task of an interpretive approach are still vague as researchers need to focus their attention on the details of language and ideology. Therefore, an anthropologist approach such as ethnographic using case studies as well as participant observations is adopted.

Thirdly, an interpretive approach assumes that people are “the ascription of human purpose to human action”(Chua, 1986:615). This purpose is grounded in the changing social context rather than pre-given. Finally, the interpretive approach is not provided with technical applications, as it does not intend to control empirical phenomena. The main aim of the interpretive method is to enrich people’s understanding about the meaning of their actions through observing phenomena within their contextual and cultural situation (Orlikowski & Baroudi, 1991). In this sense, phenomena are assessed from the participant's point of view in their natural setting and by doing so, the observation of what people are doing will increase the possibility of apprehending new forms of life and their language (Chua, 1986). There are a number of methodologies developed within the interpretive tradition: symbolic interactionism, ethnomethodology, phenomenology, grounded theory and ethnography (Chua, 1988; Lowenberg, 1993).

The interpretive paradigm adopted in accounting research follows the work of accounting scholars who position accounting practices in their socio-political and historical context. Their view is that accounting is not merely a technical aspect, but is socially constructed (Hines, 1988; Morgan, 1988), and suggests that accounting should be understood from the context in which it is being practised (Roberts & Scapens, 1985). Such a methodology has been adopted in researching accountability and governance in MFIs to investigate how Ugandan MFIs implement governance practices (Kansiime, 2009) and to explore accountability practices among officers of Zambian MFIs (Dixon, Ritchie & Siwale, 2006). These studies have broadened the scope of mainstream governance research that traditionally focuses on boards of directors or executive compensation. More importantly, the interpretive approach has the potential to narrow the gap between what is presented on financial reports and the information that stakeholders need. Therefore, it has benefit in realigning accounting with social sciences (Lehman, 2010).

However, the limitation of the interpretive perspective is that it focuses too much on interactions within the micro-social context, neglecting social conflict in the wider society as well as lacking an evaluation dimension (Chua, 1986). The critical perspective was then introduced to address the limitations in the interpretive approach.

6.2.3. Critical accounting research

The stance of critical research is also interpretive (Baker & Bettner, 1997). While the interpretive perspective focuses on the meaning inherent in human actions and experiences, the critical approach highlights the history, social aspects and context of such meanings (Fossey, Harvey, McDermott & Davidson, 2002), with the main distinctive characteristic being its evaluation dimension (Orlikowski & Baroudi, 1991). The foundation of the truth and knowledge of the critical perspective is located in the specific economic, historical and racial infrastructure of oppression and marginalisation (Guba & Lincoln, 2005), so the analysis of this approach is to correct such inequalities by removing the existing dominant practice within society.

The critical perspective takes the belief that "every state of existence, be it an individual or a society, possesses historically constituted potentialities that are unfulfilled" (Chua, 1986:619). However, the prevailing dominant system, which operates through material, economic and political relations and the level of consciousness, has restricted human potentialities, which causes them to be alienated from self-realisation. Sometimes, the form of oppression can be applied through the governing rules or the distribution and ownership of wealth. The critical perspective believes in hidden human potential, therefore studies in this field emphasise the search for the historical development of entities to understand movement, change and the reconstruction process (Chua, 1986).

Critical thought has contributed to accounting research. It broadens understanding of the wider roles of accounting. Accounting is not merely seen as a technical activity, but is considered as playing a significant role as a mechanism of control within the complexity of modern society. In this sense, accounting information has become a form of economic rationalisation, since accounting reports can effectively influence the price of financial instruments, including shares, and subsequently affect decision making (Power, Laughlin & Cooper, 2003).

The critical approach provides tools for accounting researchers to reflect on the role of accounting at the micro and macro levels (Chua, 1986). At the micro-organisational level, accounting information is like a portrait of a piece of cake that is available for distribution and the report depicts the distribution arrangements that have been made. On the other hand, at the macro-societal level, the accounting numbers can influence taxation policy making, employee wage bargaining as well as economic structuring. In short, adopting a critical approach in accounting studies is fruitful to stimulate more scholars in this field to unveil the actual functioning of accounting in society.

The main criticism of the critical perspective, as argued by Robert Kaplan, a prominent American positivist scholar, is that the approach is not scientific (Baker, 2011), as these studies mainly adopt qualitative research, which is considered less rigorous in terms of method. Moreover, the critical approach is also perceived as not being objective research, as the researchers are part of the society that they are critiquing (Weaver & Olson, 2006).

While the mainstream and critical methodologies have their own benefits, interpretive accounting research may perhaps be the most suitable approach to explore the development of accountability and governance practices in Islamic MFIs in Indonesia, for two reasons. Firstly, accountability and governance practices within organisations change over time; they are dynamic rather than static. In this circumstance, accounting numbers are insufficient to explain and represent the events experienced by human beings (Chua, 1988), while the methodological procedure within the interpretive approach makes it possible to generate knowledge about human actions. Secondly, the interpretive approach is considered as a beneficial research strategy to examine the roles and development of accounting practices in the wider context by considering the socio-economic and historical circumstances of the society in which accounting operates. In this study, the development of accountability and governance practices in IIMFIs is inseparable from the prevailing socio-political and economic conditions in Indonesia over the periods being studied.

Moreover, among different forms of methodological thinking within the interpretive paradigm, ethnography is deemed the most appropriate to achieve the objectives of this study, for a number of reasons. Firstly, getting involved in the field for a certain period enabled the researcher to build intensive interactions with various people related to the organisation. This also facilitated the researcher in exploring their beliefs, perceptions and actions, as well as in understanding their everyday life in the organisation and how accountability and governance practices are socially constructed. As Jönsson and Macintosh (1997) suggest, ethnography is valuable in understanding the way in which accounting is being practised within an actual organisational setting.

Secondly, ethnography is intended to understand and interpret a particular cultural system such as an organisation (Atkinson, Coffey, Delamont, Lofland & Lofland, 2010). This requires the researcher to be closely engaged in recording and observing another culture on a daily basis, an experience labelled the fieldwork method, and then writing a descriptive account of the experience (Bryman, 2001). Ethnography has been employed widely in accounting research because at the micro-societal level, the organisation develops its own culture (Rudkin, 2002). Since this study requires an understanding of how the organisation's religious culture and value system influence its everyday life, this approach enabled the researcher to collect a 'thick' description (Abdul-Rahman & Goddard, 1998) of the meaning of accountability and governance practices.

Thirdly, Bourdieu's theory of practice and his relational concepts of *field*, *capital*, *habitus* and *practice* require adoption of the ethnographic method (Jayasinghe & Wicramasinghe, 2011). Through interviews, observations and extensive fieldwork within the cultural setting, the ethnographic approach will enable the researcher to capture the dynamics of accountability and governance practices (Samra-Frederick, 2000) in the selected organisations. Moreover, by adopting the ethnography approach, the researcher was able to see the organisation as a system of meaningful practices that are politically and historically contingent and socially constructed (Ahrens & Mollona, 2007).

6.3. Research design

Based on the research gaps identified in Chapter 3, this study seeks to investigate how IMFIs developed in Indonesia and how accountability and governance are practised within selected IMFIs in Indonesia. Given that accountability and governance practices are socially constructed through external and internal systems, two research designs are applied to achieve the multiple research objectives. Each of these is further discussed in the following sections.

6.3.1. Examining the historical development of the Islamic microfinance sector

The first research objective is to examine the historical development of the Islamic microfinance sector in Indonesia as an external system that affects the construction and development of accountability and governance practices by IIMFIs. Hence, the focus of analysis is located at the sector level to understand the *field* of Islamic microfinance. Examining the development of this *field* requires analysis of the socio-economid and political situations relating to the birth of the initiative of financial institutions based on Islamic teaching, the Islamic awakening movement and regulation within the financial sector that shaped the dynamics of the *field*.

In other words, the research design employed to address the first research objective must be able to aid in providing a narrative history of the emergence and development of Islamic microfinance over the period. Therefore, the historical research method is deemed appropriate for this part of the study. The historical approach is basically descriptive and comprises a narration of what has happened in a time sequence (Savitt, 1980). As suggested by Rowlinson (2005), there is no single approach that can be used in adopting historical research. However, it generally encompasses the following steps: data collection, evaluation of the material collected, data analysis and reporting.

6.3.1.1. Data collection

Within the historical approach, the source of information can be divided into two categories: primary and secondary resources (Savitt, 1980; Rowlinson, 2005). A primary resource refers to one that involves the researcher directly in acquiring the data, such as through diary research and interviews (Glatthorn & Joyner, 2005) In contrast, a secondary resource can be obtained with the indirect involvement of the researcher, such as through utilisation of materials in newspapers, organisational records, relics and photographs (Glatthorn & Joyner, 2005). For the purposes of this study, both resources are sought to aid in providing a rich narrative for the *field* of Islamic microfinance in Indonesia.

6.3.1.1.1. Interviews

An interview is a conversation with a purpose. In the historical approach, interviews are conducted with people who have experience and knowledge related to the research topic, also known as oral histories (Rowlinson, 2005). There are different types of interviews: structured, semi-structured and unstructured or in-depth interviews (Saunders, Lewis & Thornhill, 2012). For this study, the semi-structured interview was adopted as it allows the researcher to have a list of themes with some key questions to be covered. The steps involved in the preparation and conduct of interviews in achieving the first research objective are further explained below.

1. Selecting interviewees

   There are a number of developmental institutions that have played significant roles during the emergence and development of IMFIs (Wahyuni, 2007), such as PINBUK (*Pusat Inkubasi Bisnis Usaha Kecil* – Centre for Small Business Incubation), ABSINDO (*Asosiasi BMT seluruh Indonesia* – Association of Indonesian Islamic Microfinance Institutions) and INKOPSYAH (*Induk Koperasi Syariah* – Shari'ah Savings and Loan Cooperative). Interviewing people from those institutions is vital because they are considered the most appropriate people who have extensive knowledge on the development of Islamic MFIs in Indonesia. Access to the interviewees was obtained through Indonesian colleagues and the participants agreed to be interviewed.

2. Development of the interview guide

   The interview guide was constructed based on the important concepts and themes identified from the literature on Islamic microfinance in Indonesia, as well as the concept of *field* in Bourdieu's theory of practice. The interview questions were first constructed in the English language and revised several times based on feedback and pilot testing with Indonesian colleagues who have knowledge in the area. Once the final themes and questions were finalised, they were then translated into the Indonesian language and checked by a colleague who is well versed in both languages. The reason for conducting the interviews in the Indonesian language is because most interviewees indicated a preference to be interviewed in this language. The interview guide used in this part of the study can be found in Appendix B.

3. Ethical clearance for interviews

   In order to ensure quality and ethical acceptability, this study followed 'The Ethical Procedures for Research' developed by the University of Hull Business School. The ethical clearance for conducting interviews was granted in August 2012, prior to the data collection in Indonesia.

4. Conducting the interviews

   Prior to conducting the main interviews in Jakarta, the researcher attended the International Microfinance Conference, on 22–23 October 2012, and the Microfinance Summit, on 5–6 November 2012, both of which were held in Yogyakarta, Indonesia. During these events, the researcher had opportunities to conduct additional interviews with microfinance practitioners, the chairman of the *Perhimpunan* BMT (PBMT, Association of Islamic MFIs) and its external affairs officer. Attendance at these events broadened the researcher's knowledge on the contemporary movement of Islamic MFIs, especially in Indonesia.

   The key interviewees were all based in Jakarta. Therefore, at the beginning of October 2012, the schedules were re-confirmed to make sure that the interviewees were still available for interview on the dates and times in November 2012. The interviews were conducted with the selected interviewees at their respective offices:

   a. Chairman and advisor of ABSINDO

      ABSINDO is the Association of Islamic BMTs in Indonesia whose aim is to become a self-regulating organisation for their members. In order to further understand the roles, functions and operations of ABSINDO, the chairman provided the contact numbers of the advisor and volunteers of ABSINDO and recommended that the researcher interview them as well. Therefore, the original list of potential interviewees was amended accordingly.

b. Chairman of PINBUK

   PINBUK was established in 1995, and it played a significant role in supporting the establishment of IMFIs across Indonesia by providing basic training in establishing, fundraising and administering IMFIs.

c. Chairman of Economic and Entrepreneurship Council of the National Office of Muhammadiyah

   This council was established to supervise Islamic MFIs operating under the name of Muhammadiyah.

d. Staff from the Indonesian Ministry of Cooperative and Small and Medium Enterprises

   According to the law, the Ministry has the responsibility to supervise and monitor the operations of cooperatives, including IMFIs that are registered as cooperatives.

In total, the in-depth interviews were conducted with 5 respondents, including the chairman of PBMT, practitioners, ABSINDO volunteer and auditor. However, only the profiles of relevant interviewees are presented in Table 6-1.

Table 6-1 Interviewees for examining the *field* of Islamic microfinance

Code	Position	Gender	Age	Educational qualification	Date of interview	Total duration
ST 01	Chairman of ABSINDO	Male	40–50	Master's (banker)	26 Nov 2012	1 hr 33 mins
ST 02	Advisor at ABSINDO	Female	40–50	Master's (banker)	26 Nov 2012	48 mins
ST 03	Chairman of PINBUK	Male	40–50	Master's	27 Nov 2012	1 hr 15 mins
ST 04	Chairman of the Economic and Entrepreneur-ship Council of the National Office of *Muhammadiyah*	Male	40–50	Master's (lecturer)	28 Nov 2012	68 mins
ST 05	Staff from Indonesian Ministry of Cooperatives of Republic Indonesia	Male	40–50	Master's	29 Nov 2012	1 hr 13 mins

5. Transcription of interviews

All the interviews were digitally recorded. Since the interviews were conducted in the Indonesian language, it was impossible to use transcription software such as Dragon Naturally Speaking, as the software does not support this language. Therefore, the transcriptions were done manually by listening to the tapes, pausing and typing up the interview conversations. The completed transcriptions were then sent to the interviewees for their approval and no amendments were made by the interviewees. Only the relevant parts of the transcriptions were translated into English.

6.3.1.1.2. Secondary sources

Based on the initial literature review on Islamic microfinance in Indonesia, the development of IMFIs in Indonesia has been influenced by the socio-economic and political situation. In order to describe and analyse Indonesia's macro-economic and political condition from its emergence to the present time, secondary sources, which refer to data that has been collected by others such as publicly available reports of organisations, internal documents produced by organisations, government reports or published academic research (Harris, 2001), have been utilised. The advantages of using secondary resources is that they help the researcher to utilise the breadth of data available, especially in situations when the real actors were unavailable or difficult to interview (Boslaugh, 2007). The secondary data used for this study was primarily from the published academic research related to the socio-economic and political situation that drove the emergence of Islamic MFIs in Indonesia.

6.3.1.1.3. Evaluation of the collected secondary material

The information from secondary sources must be evaluated and pass two evaluation criteria: external and internal criticism. The former is related to the process of determining the trustworthiness, authenticity and validity of the sources, while the latter is related to the process of determining the accuracy and reliability of the information contained in the sources (Rowlinson, 2005). The published articles used in this study fulfilled both evaluation criteria, as they have undergone the peer review process; that is, the article has been scrutinised and reviewed by a third party (Rowland, 2002) and the process helped to correct any errors or inaccuracy prior to the papers being published (Smith, 2006). The use of secondary data in this study aims to corroborate and confirm the interviews and fill the gaps in information for periods of which interviewees may not have direct knowledge. As Jupp (2006) suggests, using more than one source in research will enhance the value of the information collected.

6.3.1.2. Data analysis

Bourdieu suggests that when investigating the *field*, four aspects of relationships must be analysed: the social history of the *field*, the relationship of the *field* with other *fields*, the specific struggles within the *field* and the current dynamics of the *field* (Kay & Laberge, 2002).

Following this suggestion, data from interview transcriptions and relevant journal articles on Indonesia's socio-economid and political situation were analysed to trace the historical development of the *field* of IMFIs. Since the emergence of IMFIs in Indonesia was closely related to the initiative of rural microfinance, the socio-political and economic conditions, the financial reforms and the Islamic movements in Indonesia, the analysis involved three steps. The first step involved identifying the timeline of the emergence and development of IMFIs to the present time. Based on this step, four periods were identified representing the major steps in the development of Islamic MFIs for the purposes of this study: the Dutch period, post 1980 to 1990, post 1990 and 2000, and post 2000 up to the present. In the second step, the major events in the history related to the socio-economic and political situation and financial reforms were identified from the literature. In the final step, the milestones of the microfinance initiatives were identified and linked back to the wider socio-political context and the financial reforms of the corresponding period, to provide a contextual narrative of the development of Islamic MFIs.

6.3.2. Investigating the construction and development of accountability and governance practices in selected IIMFIs

The second research objective of this study is to investigate how accountability and governance practices are constructed and developed within Islamic microfinance organisations. This focuses on the internal system and, hence, the analysis is at the organisational level to gain an understanding of how *capital* and *habitus* affect the *practice* of accountability and governance within the organisation. Since the accountability and governance practices of IIMFIs were socially constructed within the Islamic culture, the ethnographic approach is deemed appropriate in investigating the construction and development of such practices.

6.3.2.1. Ethnographic research approach

The term ethnography does not have a standard and well-defined meaning, but this approach is commonly used to study human social life (Hammersley & Atkinson, 2007). Hence, this research method is concerned with understanding how human activities are related to the context and belief system. Accordingly, this method allows the researcher to be involved in people's daily lives, covertly or overtly through 'watching what happens, listening to what is said, and/or asking questions through informal and formal interviews, collecting documents and artefacts – in fact, gathering whatever data are available to throw light on the issues that are emerging focus of inquiry' (Hammersley & Atkinson, 2007:3).

The principal aim of ethnography is to look beyond what people say by understanding the shared system of meaning that is 'culture' (Goulding, 2005). Such meanings are continuously produced and reproduced within specific social and cultural contexts. In this sense, the researchers themself can be part of interactive-meaning making. Therefore, qualitative research requires reflection or the process of self-reference that refers to awareness that the personal identity (background, experience, assumption, belief and interest) and the process of doing research (from the initial conception, data collection, analyses, and writing) affect the products of research (Davies, 2002; Brown & Broadman, 2011).

As a female wheelchair user, the researcher is aware of the difficulties and barriers in conducting this study, primarily in accessing the research site due the absence of accessible public transport and office building facilities. These issues are addressed by utilising my private car and asking for assistances to lift up my wheelchair for accessing the building. Fortunately, the main activities of IIMFIs were located at the ground floor, thus the interview process and observations can be conducted. Moreover, the researcher was also accompanied by her husband who always assists in documenting the process of interview and observation through video recording.

Prior to the field research, the researcher was also concerned about the negative attitude and perception attributed to a disabled people (Brown & Broadman, 2011). However, these concerns did not materialise during the data collection. The researcher felt that she was treated with sympathy. The staff members, management and the board provided massive support by freely giving their time to be interviewed. The researcher adopted a strategy to establish a rapport with the most influential people within the organisation. Once the managers of the IIMFIs provided their support, the subordinate staffs followed their instructions to provide information and data required for this study. Moreover, since the researcher has a similar ethnicity background with the majority staff, access to the research sites, as required in an ethnographic approach proceeded smoothly.

In general, the main features of ethnographic work encompass a set of activities: selecting and sampling cases, gaining access, interviewing and observation, recording data and analysis (Hammersley & Atkinson, 2007). The following sections provide further details on how the research was conducted.

6.3.2.2. Data collection method

6.3.2.2.1. Selecting settings and cases

The most important step in an ethnographic study is identifying the sort of locations or study setting that would be most appropriate in investigating the research problems (Hammersley & Atkinson, 2007). Ethnographers can conduct ethnography in multiple locations (multi-sites), historically, online and virtually (O'Reilly, 2009), and each of these options raises its own issues for access and collecting data.

According to Seibel and Agung (2005), IMFIs in Indonesia can be classified into two categories: BMT (*Baitul Maal wat Tamwil*), which comprises about 95% of IIMFIs, and BTM (*Baitul Tamwil Muhammadiyah*), which comprises about 5%. BMTs were established by those who are associated with the *Nahdlatul Ulama* (NU), the biggest Islamic mass organisation in Indonesia, while BTMs were established and supervised by the *Muhammadiyah*, the second biggest Islamic mass organisation in Indonesia. As discussed in Chapter 4, some differences exist between the NU and *Muhammadiyah* in terms of their Islamic ideology, cultural norms and the practices that are expected to be manifested in their *habitus*. Moreover, BMT has a mixed commercial and social mission, while BTM has a more definite commercial mission. Due to such differences, their accountability and governance practices may be different. Hence, it was decided for the purposes of this study to select two case studies, one representing a BMT and the other a BTM.

Due to the massive number of IIMFIs,[8] a method called sampling within the case (Hammersley & Atkinson, 2007) was adopted. Since the study requires the selection of cases (organisations) for in-depth study based on the two types of IIMFIs, purposive sampling was used, as it enabled the researcher to establish criteria to select the cases from which the most can be learnt (Merriam, 2009). In this study, two criteria were used in selecting the cases: the organisation must have operated for more than 10 years, and the assets of the organisation must be more than IDR 1 billion. The reason for considering only IIMFIs that have operated for more than 10 years was an indication of their success in continuing their operations for a long period.[9] The reason for considering only IIMFIs that have an asset value of more than IDR 1 billion was an indication of their economic growth, and the issues of accountability and governance will be more prominent in such organisations.[10]

The researcher conducted an internet survey to find IIMFIs that meet the two set criteria, but failed to find suitable cases due to the unavailability of information on

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[8] The accurate number of IIMFIs is not available, but it was estimated that there are more than 4,000 IMFIs existing by the end of 2011 (Perhimpunan BMT Indonesia. (2012) Bangga berkoperasi, bangga bersyariah *BMT Summit*: at Yogyakarta.

[9] The CGAP (Consultative Group to Assist Poor), a global partnership of 34 leading organisations that seeks to advance financial inclusion, established a guideline for evaluating the level of sustainability of microfinance institutions. The guideline states that ideally MFIs should be able to cover their costs without subsidies or achieve financial sustainability within 5–10 years.

[10] According to INKOPSYAH (*Induk Koperasi Shari'ah*), Islamic cooperatives are classified into five groups based on their assets: a) > IDR 1 billion (± £50,000); b) > IDR 500 million–1 billion (± £25,000–£50,000); c) > IDR 250–500 million (± £12,500–£25,000); d) > IDR 50–250 million (± £2,500–£12,500); and e) < IDR 50 million (± £2,500). Categories a, b and e make up 22% of IIMFIs, while categories c and d make up 40% and 38% of IIMFIs, respectively (INKOPSYAH, 2011).

the internet. Therefore, at the beginning of July 2012 the researcher contacted the chairmen of INKOPSYAH and ABSINDO (Association of Indonesian BMT) to seek their advice on finding IIMFIs that meet the criteria.[11] The chairmen of both organisations recommended BMT A in Pasuruan, East Java, as this organisation is strongly influenced by the *kyai* (Islamic leader) from *Nahdlatul Ulama*. Since none of the BTMs is a member of INKOPSYAH or ABSINDO, the researcher contacted the office of *Muhammadiyah* for suggestions of BTMs that meet the criteria. The secretary of *Muhammadiyah* recommended BTM B in Pekalongan, Central Java, as it is the first and biggest BTM in Indonesia. The next step involved getting access to these two selected cases.

6.3.2.2.2. Getting access

Obtaining access to the field is a major problem in ethnographic research (Hammersley & Atkinson, 2007), as there are many barriers to access related to personal attributes of the researcher, such as age, gender, religion and ethnicity (O'Reilly, 2009). Since the field is the heart of ethnography (Fetterman, 1998), researchers should anticipate the difficulties and problems likely to be incurred during data collection (Hammersley & Atkinson, 2007).

Prior to conducting field research, around July 2012 the researcher contacted the directors of BMT A and BTM B over the phone to introduce herself and briefly explain her intention to conduct research in their institutions. For their consideration, they requested formal letters explaining the purpose of the research, the estimated time for the research and a further description of the research. Once the documents

[11] The researcher obtained the contact number and email address of the chairmen from a colleague, as discussed in Section 6.3.1.1.1.

had been submitted (along with the consent letter as presented in Appendix C), they provided approval to conduct the research and required the researcher to contact them further to discuss the appropriate time. The concern form was completed, as presented in Appendix D.

At the beginning of September and October 2012, the researcher made a second contact with the managers of BMT A and BTM B to confirm a convenient time for conducting one week's research in their institutions. The researcher also explained her intention to conduct interviews with the board of directors, managers, members of staff and clients and to observe their daily activities. Permission was provided to visit BTM A in the third week of September 2012 and BTM B in mid-October 2012.

6.3.2.2.3. Interviews

Ethnographers produce data through conducting interviews, engaging in numerous informal conversations, asking questions and listening to the answers, undertaking non-participant observation as well as collecting various documents (Ahrens & Chapman, 2006). In ethnographic research, the interview aims to gather rich and detailed data from the participants. To achieve this objective, the interview should not be in a formal setting with a pre-arranged meeting, but it can be conducted simply through conversations at various times and places (O'Reilly, 2009). This approach is well known as flexible interviewing or conversationally flexible interviewing (Currivan, 2008). Despite being conducted in the shape of an informal setting, it does not mean that the interview does not require preparation.

This study prepared an interview guide or protocol to help the researcher in directing the conversation towards the topics and issues of concern. As suggested by Mason (2004), an interview guide is a list of topics or themes that is normally linked to the research question. Therefore, the interview guide for this study was derived from the research objectives, research questions and theoretical framework. The questions were categorised into four main themes based on the theoretical framework of this study: *field*, *capital*, *habitus* and *practice*. The interview guide was discussed with the supervisor to ensure that it covered the research questions in this study. The interview guide was constructed in English and revised several times. Once the questions were finalised, the guide was translated into the Indonesian language, as all the interviewees are native speakers of this language (see Appendices E and F). Moreover, prior to conducting the data collection, the author obtained ethical clearance, as discussed in Section 6.3.1.1.1.

6.3.2.2.3.1. The pilot interview

During the development of the interview guide, the researcher conducted a pilot test. This step helps researchers to identify whether there are any limitations or weaknesses in the interview guide, so enabling them to make necessary revisions prior to embarking on the study (Kvale, 2007). The potential respondents for the pilot interview were selected randomly from the BMTs' Facebook pages and the researcher sent a message to introduce the study and explain the aim of contacting them and ask whether they were willing to be interviewed about their institution. Five BMTs responded and were ready to be contacted, and the researcher selected two directors of a BMT in Aceh and a BMT in Bogor, West Java on 3 August 2012 and 6 August 2012, respectively, as they were the most suitable for giving feedback for the pilot interview. The interviews were conducted over the phone, and took about one hour for each respondent. The author asked the questions in the interview guide to test whether the questions could be understood by the respondents as well as to get experience of the best way to interview people. The main lesson from this process was for the researcher not to follow the sequence of the list of questions strictly in order to keep the conversation going. Moreover, the researcher had some experience in developing the skills of interviewing.

6.3.2.2.3.2. Preparation prior to interviews

Prior to conducting the main study, the researcher translated the interview guide into the Indonesian language. The lesson learnt from the pilot study was that asking questions by following the themes strictly did not allow the conversation to go smoothly. Therefore, the interview guide was re-drafted based on grouping of the selected interviewees (the boards, the directors, the management team, members of staff and members of the cooperative); that is, asking questions that were relevant to the role of the interviewees. The list of questions was sent by fax to the managers of BMT A and BTM B prior to conducting the main study. By doing this, the interviewees could make preparations to answer the questions, hence misinformation could be avoided.

6.3.2.2.3.3. The interview process

The interview processes conducted within BMT A and BTM B were slightly different. The director of BMT A allowed the researcher to stay in the office during its opening hours, from 7 am to 2 pm. Since the offices of the boards, the director and the management team and the branch of BMT A are all located in the same building, this helped the researcher to meet the prospective interviewees, introduce herself and ask what time they would be free for the interview.

In contrast, the director of BTM B only allowed the researcher to visit its office after lunchtime, from 1 pm to 4 pm, as the members of staff were usually busy in the morning. Moreover, the members of the boards only visited the office of BTM B for a regular meeting every three months, so the researcher had to make separate arrangements for interviewing them. Three out of five members of the boards were interviewed in their offices and the other two were not available. However, the questions in the interview guide were be covered by the interviewees.

Interviewing members of staff at both BMT A and BTM B was conducted through informal conversations. The researcher approached them and started to engage them in conversation when they seemed to be free. The conversations were mainly related to their backgrounds, jobs, responsibilities and work experience. The conduct of the interviews was as follows. Firstly, the researcher greeted them and expressed her thanks for giving their time to participate in the interview. Then the researcher introduced herself as a doctoral student conducting research to understand more about the activities of the organisation, and also sought permission to record the interview using a digital voice recorder and video recorder, assuring them that all the information would be kept confidential and would only be used for the research purposes. All the interviewees agreed to be recorded, using either the digital voice recorder or video recorder. The researcher next explained the participant's rights to decline to answer any questions they did not wish to, but none of them refused to answer the questions posed to them during the interview. During the interview, the researcher did not strictly refer to the interview guide, but instead followed the flow of conversation with the interviewees. While taking notes and listening to the answers, the researcher identified the points or questions in the guide that may be relevant but had not yet been covered by the interviewees. The profile of interviewees in BMT A and BTM B is presented in Table 6-2 and Table 6-3.

Table 6-2 Interviewees at BMT A

Code	Position	Male/ female	Age range	Date of interview	Duration of interview	Total duration
SD01	General manager	Male	50–60	13 Sept 2012	92:21 30:23	2 hrs 47 mins
				24 Sept 2012	00:30	
				26 Sept 2012	42:11	
SD02	Head of branch 1	Male	40–50	23 Sept 2012	45:01	2 hrs 25 mins
				24 Sept 2012	104:44	
SD03	Marketing manager	Male	40–50	23 Sept 2012	96:47	1 hr 36 mins
SD04	Account officer 1	Male	40–50	24 Sept 2012	10:25 22:34	32 mins
SD05	Secretary of the boards	Male	40–50	24 Sept 2012	109:10	1 hr 49 mins
SD06	Chairman of the boards	Male	60–70	24 Sept 2012	114:50	1 hr 54 mins
SD07	Small trader	Male	30–40	25 Sept 2012	05:11	5 mins
SD08	BMT AA officers: - Marketing manager - Secretary of the boards - Second vice-chairman	Male Male Male	40–50 50–60 60–70	25 Sept 2012	139:19	1 hr 19 mins
SD09	Operational manager	Male	40–50	25 Sept 2012	73:08 51:44	2 hrs 4 mins
SD10	Account officer 2	Male	20–30	25 Sept 2012	18:22	18 mins
SD11	First vice-chairman	Male	50–60	26 Sept 2012	51:14	51 mins
SD12	Head of branch 2	Male	40–50	4 Oct 2012	111:22 30:19	2 hrs 21 mins

Table 6-3 Interviewees of BTM B

Code	Position	Male/ female	Age range	Date of interview	Duration of interview	Total duration
WR01	General manager	Male	40–50	8 Oct 2012	139:41	2 hrs 19 mins
WR02	Chairman of the boards	Male	50–60	8 Oct 2012	90:42	1 hr 30 mins
WR03	Head of supervisory board	Male	40–50	9 Oct 2012	128:19	2 hrs 8 mins
WR04	Marketing staff	Female	30–40	9 Oct 2012	19:40	45 mins
				10 Oct 2012	07:12	
				10 Oct 2012	19:54	
WR05	Head of account officer	Female	30–40	9 Oct 2012	10:05	1 hr 2 mins
				10 Oct 2012	62:10	
WR06	*Shari'ah* supervisory board	Male	60–70	9 Oct 2012	56:29	56 mins
WR07	Account officer	Male	20–30	10 Oct 2012	32:24	32 mins
WR08	Accounting staff	Female	30–40	10 Oct 2012	63:18	63 mins

6.3.2.2.3.4. Post interview

Interviewing involves a continuous process of reflection about the research, including the way in which meanings were produced and reproduced in a specific context (Kvale, 2007). Therefore, reflection can be seen as learning from experience. Soon after the interview, the researcher immediately checked the digital voice recorder and video recorder to see whether the device worked properly and that the quality of recording was acceptable. Due to the limited capacity of the video recorder's memory card, the researcher transferred the video file to a laptop immediately after completing each interview, while the voice recorder file was transferred to a laptop at the end of each day. During the transfer process, the researcher had the opportunity to listen to and watch the video for a few minutes.

This helped her to self-critique her interview skills. Moreover, at the end of each day, the researcher reflected on the interview guide to identify questions that had not been covered, as well as to highlight certain points from the interviews that required further explanation. The researcher created a new list of questions and identified who should be approached for clarification. This process was conducted every day during the fieldwork to ensure that all the questions were covered.

6.3.2.2.3.5. Transcribing the interviews

All the interviews were transcribed by the researcher herself as soon as possible after the interview. Transcribing the interview into a written mode of structure is deemed an initial analysis (Kvale, 2007). There was a few weeks' break between the fieldwork in BMT A and BTM B, hence the time was used to transcribe the interviews in order to gain new insights for subsequent interviews. All the interviews were conducted primarily in the Indonesian language, but mixed with the Maduranese language in BMT A and the Javanese language in BTM B. The researcher was born in a Javanese family and grew up in a Maduranese environment, so there was no gap in understanding the language that the interviewees used. The local languages were also transcribed, as they are pronounced with the additional meaning in the Indonesian language shown in brackets. Moreover, as BMT A is established from the *pesantren* (Islamic boarding school), the interviewees very often quoted verses from the *Quran* or *Hadith*, so the researcher, who is a Muslim, is familiar with the verses, and the transcription was conducted by translating the verses into the Indonesian language.

The transcription process was conducted manually by listening to the interview recording and writing the conversation at the same time. This process was time consuming, as the researcher had to pause the recording regularly because the speed of conversation was much faster than the speed of typing. The transcription process was completed by March 2013.

6.3.2.2.4. Observation

The ethnographic method relies partly or substantially on participant observation (Hammersley & Atkinson, 2007), in which the researcher learns by being involved in day-to-day activities in the research setting (Kawulich, 2005). Anthropologists or other social researchers have traditionally spent months or even years living and observing in the field, while accounting researchers who have adopted ethnography have tended to spend less time in organisations (Ahrens & Chapman, 2006). However, this does not mean that during their short time in the field they obtain only a superficial understanding of accounting practices. This is because accounting researchers have been familiar with the social realities within the organisation, such as the management and accounting system (Ahrens & Chapman, 2006).

Due to physical and cultural barriers in the research setting, the researcher could not conduct participant observation. In BMT A, for example, all the staff members are male and there were restrictions on the mixing of genders at the workplace. Moreover, the researcher could not observe the activities of the team management and the boards, as their office was on the first floor and it was not accessible for the researcher, who is a wheelchair user. Therefore, the researcher could only observe activities by watching the process, interactions among people and their behaviour in the organisation.

Prior to collecting data, the researcher prepared an observation guide identifying what aspects the researcher should focus on, such as activities, behaviours or processes. During data collection the researcher observed a number of activities, as illustrated in Table 6-4. Some activities were only found in BMT A, such as ritual praying in the morning and evening prior to the opening hours and after the closing time, and collecting savings directly from small traders.

Table 6-4 List of activities observed

No	Activities	BMT A	BTM B
1	Ritual praying prior to opening and after closing the office	Y	
2	Activities in the front office	Y	Y
3	*Uqud* (contract signing) process	Y	Y
4	Daily cash checking	Y	Y
5	Collecting savings from small traders in the traditional market	Y	
6	Collecting savings from members of *pengajian*		Y
7	Documentation of recording	Y	Y
6	Documentation of financial report	Y	Y

The reflection process during observation in the ethnographic method is called writing fieldnotes. These describe the setting, participants, what happened and the activities and comments of the researcher (Emerson, Fretz & Shaw, 2011). The researcher wrote fieldnotes during and after the interview and observation (sees the sample in Appendix G). This reflection consisted of 1–2 pages of description of activities during the day from morning until evening, what happened, the people involved, the researcher’s impression of what was happening, the description of the layout and the interior office of the organisational site. The notes also included the problems encountered by the researcher, such as the limitation of video recording that could record a maximum of 40 minutes, how to prepare another plan to overcome this issue, and arranging the list of activities required to be observed for the following days. This reflection helped the researcher to improve her interview skills as well as plan the research activities. Moreover, the notes were also useful in the data analysis.

6.3.2.2.5. Secondary data

In ethnographic research, documents and other material artefacts are deemed important to construct facts, and to diagnose the rules and decisions that are crucially involved in social activities (Hammersley & Atkinson, 2007). This study also used internal documents published by BMT A and BMT B to support the information provided during the interviews and observations. The list of documents acquired is presented in Table 6-5.

Table 6-5 List of secondary data

No	Documents/forms	BMT A	BTM B
1	Company profile	Y	Y
2	Annual reports	Y	Y
3	Product pamphlets	Y	Y
4	Guidance for establishing BTM		Y
5	Standard Operational Procedure	Y	Y
6	Standard Operational Management	Y	
7	*Uqud* (contract)	Y	Y
8	Application form for loan	Y	Y
9	Forms for saving and withdrawal	Y	Y
10	Forms of instalment loan	Y	Y

The documentary evidence assisted the researcher during the interview, observation and data analysis. During the interview and observation, when the interviewees answered the questions, the researcher confirmed the answer with the information available in the documents. Moreover, the documents also helped the researcher to understand the process of loan approval from application to evaluation, disbursement and payment, as part of the accountability of utilising the fund. With regard to accountability and governance practices, the documents helped the researcher to explore further the organisation's vision, mission, organisational structure, job description, internal control mechanisms, decision making, financial reporting, financial control and financial audit.

In the data analysis stage, the documents were used to assist in interpreting the interviews and observations. Moreover, in the writing stage, the information in the documents was excerpted to support the analysis, such as evidence of the growth in economic capital as indicated by the increasing assets over the years that can be found in the annual reports.

6.3.2.3. Reliability and validity of data collected

Reliability and validity are common criticisms of qualitative research; while the issue of reliability focuses on replicability, validity is concerned with the accuracy of scientific findings (Morse, Barret, Mayan, Olson & Spiers, 2002). The results of ethnographic research are very often deemed to be unreliable and lacking in validity and generalisability (LeCompte & Goetz, 1982). The main constraint of ethnographic reliability is because the research is often conducted in a natural setting, so the unique situation cannot be precisely reconstructed. Furthermore, the validity problems in ethnographic research may arise due to the difficulties in developing scientific measurement to obtain social phenomena.

In order to respond to the criticisms as well as produce a robust result in ethnographic research, a number of major strategies need to be developed: ensure an early familiarity with the organisation's context, triangulation, researcher's reflective commentary, member's check, mechanically recorded data and thick description (Brink, 1993; Shenton, 2004). Developing familiarity or 'prolonged engagement' between the researcher and the participants aims to gain an adequate understanding of organisational operations. It can be achieved through consultation of appropriate documents or visiting the organisation prior to data collection. In this study, the researcher developed a familiarity with the operation of IIMFIs via the literature and conducting the pilot study. The second strategy is triangulation, which involves different methods of collecting data or using a wide range of informants. This study utilised both forms of triangulation by collecting data through interviews, observations and document evidence. Moreover, this study also involved various groups of participants, such as board members, directors and the management team as well as staff members.

The researcher's reflective commentary is useful in monitoring the development of the researcher's thinking in linking the findings to the theory that underpins the research. The researcher wrote fieldnotes during and after the observation and interview. The member check method also improves the credibility of the results. This was done by sending the interview transcriptions to the participants, and asking them to read these and provide necessary comments or objections. Another strategy to improve reliability and validity is the use of mechanical devices for recording and preserving the data, so that its veracity can be confirmed by other researchers. In this study, all interviews were recorded using a digital voice recorder and some were recorded using a video recorder. Moreover, a number of activities were documented by taking photographs or recorded by video recorder. The last strategy is thick description, which provides a detailed description of the situation and context that has been researched to help readers gain insight in validating that the overall findings are true.

6.3.2.4. Data analysis

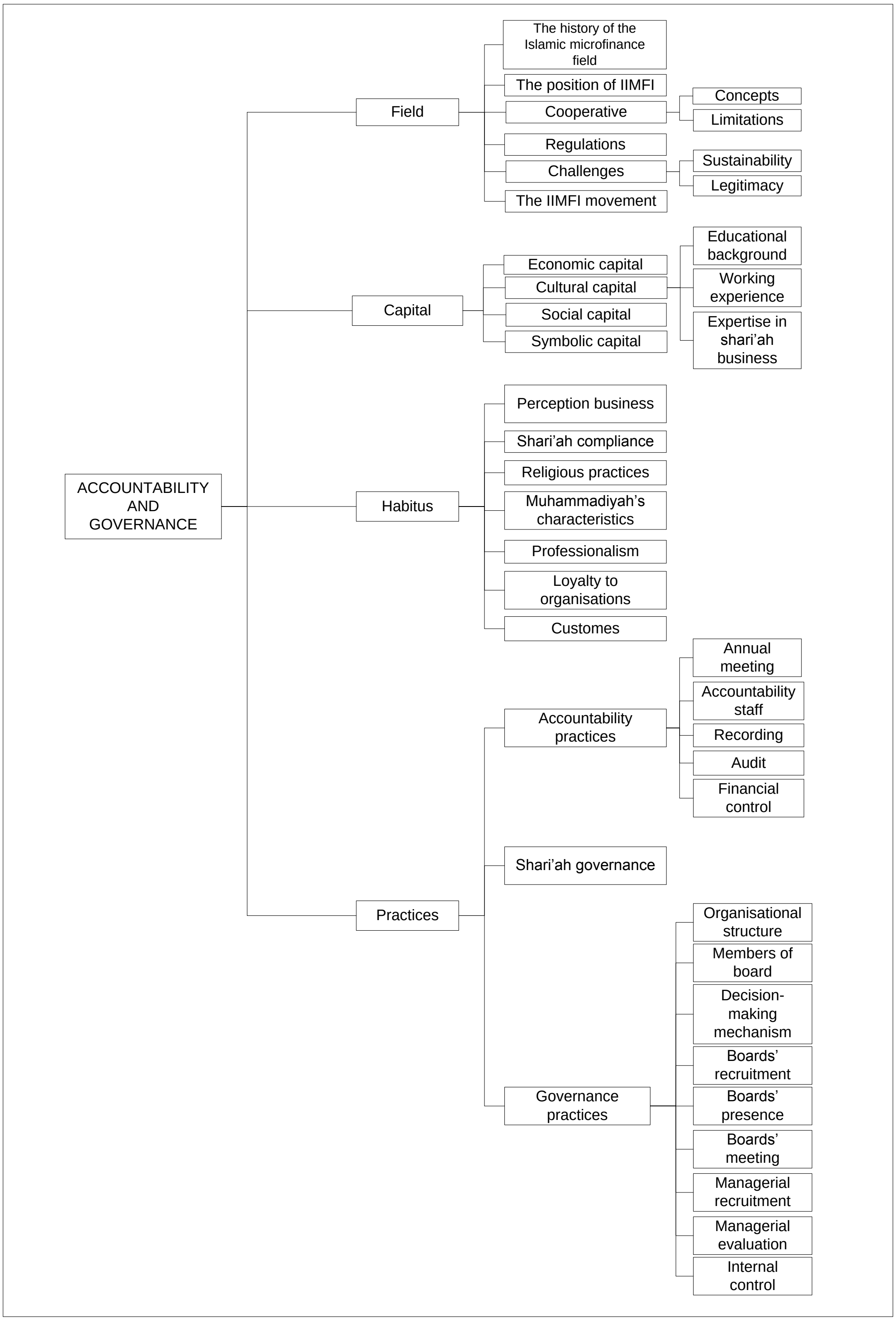
Analysis is described as a close engagement with the data to illuminate meaning and significance using a technically sophisticated method (Bazeley, 2013:4). There is no best method of analysing ethnographic data (Hammersley & Atkinson, 2007), and the process of using data is more challenging than the process of gathering data (O'Dwyer, 2004). The process of data analysis is conducted through the use of conceptualisation (Saunders, Lewis & Thornhill, 2012), which involves linking to the theory that underpins the research (Hammersley & Atkinson, 2007) and is guided by the theoretical framework (Marginson, 2013).

Qualitative data analysis embraces three major sub-processes: data reduction, data display and data interpretation (O'Dwyer, 2004). This study expanded the process into four stages: 1) integrate related data from interviews, fieldnotes and documents; 2) link raw data to research questions; 3) identify key terms for further exploration; and 4) data interpretation. To analyse the data, this study utilised NVivo software and manual analysis. The reason for using the data analysis software was because it enabled the researcher to code, re-code, search, re-search, store and retrieve in an effective way (O'Reilly, 2009). However, in interpreting the data, the researcher's input remains central in understanding the nature of social reality. This study used NVivo in the early stage of analysis by importing the raw data of interview transcripts in the Indonesian language.

After importing all the data, the next step was linking the data to the research questions, because the process of collecting data was guided by the interview guide. In the beginning, the unstructured data was linked to themes. It required identifying, labelling and structuring the data, which is well known as coding (O'Reilly, 2009). The coding process for this study was conducted in NVivo and the codes are called 'nodes'. All the transcripts were coded into the four themes: *field, capital, habitus* and *practice*.

Some parts of the text could not be classified into those themes, thus requiring the creation of new nodes that may be relevant for interpreting the data. The coding process was iterative, complicated and time consuming. The nodes were also required to be organised and structured according to the theoretical framework. Therefore, some nodes were created, reduced, deleted, merged, moved, changed or organised into a hierarchy. The outcome of the nodes from the process is presented in Figure 6-2.

Figure 6-2 The nodes from the coding process



Source: Author.

After obtaining the typology of the data as illustrated in Figure 6-2, manual data analysis was undertaken. The coded data was subsequently analysed and interpreted using narrative analysis. The narrative mode is deemed appropriate for ethnographic research (Hammersley & Atkinson, 2007). This mode provides tools to enrich the reporting of events by dividing each part of the narrative into three categories: 1) an event structure that reports what happened; 2) a description structure that explains the background information about people, time, place and context; and 3) an evaluation of the structure that presents the judgement from the ethnographer's perspective (Cortazzi, 2010). In narrating events, the ethnographer will demonstrate how people act and react within particular social circumstances. This suggests that narrative analysis is an appropriate method used in achieving the research objectives of this study.

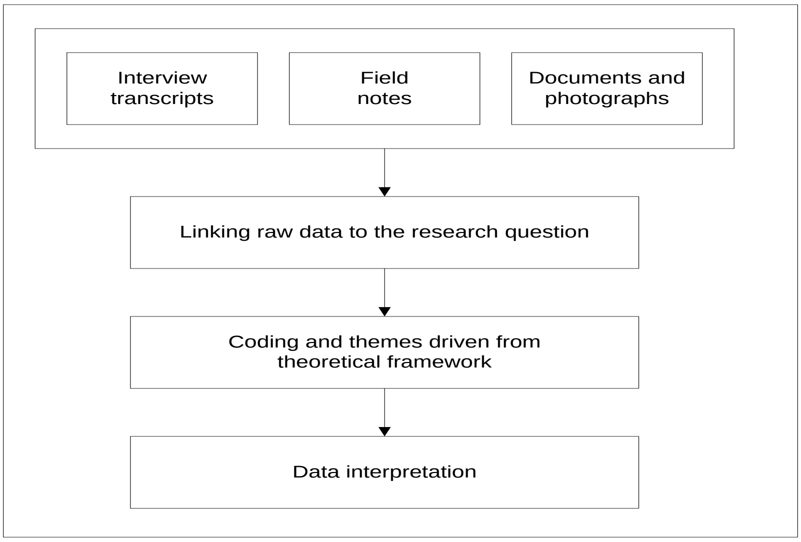
Moreover, since discourse of the concerned Islamic group had shaped their practice within the organisation, discourse analysis (DA) is also used in this study. DA is part of the linguistic research tradition, but it is not interest in language per se (Moufahim, Humphreys, Mitussis & Fitchett, 2007). It emphasizes the role of language to social, political and cultural formation as well as the construction of social reality (Trappes-Lomax, 2004). Through analysing the historical and social context, DA is deemed as appropriate approach to explore the relationship between text and context and investigate the process of social construction (Phillips & Hardy, 2002).

According to Schneider (2013) there are ten steps to conduct a systematic discourse analysis : 1) establish the context, 2) explore the production process, 3) prepare material for analysis, 4) code the material, 5) examine the structure of the text, 6) collect and examine discursive statements, 7) identify cultural references, 8) identify a linguistic and rhetorical mechanism, 9) interpret the data and 10) present the findings. Since this study primarily adopts a narrative analysis, the toolbox for analysing discourse analysis was tailored to fit the context of this study by passing through step 5, step 6 and step 8 that mainly focuses on the text.

In doing narrative analysis, the mind maps, graphs and flowchart were prepared, re-drafted and revised several times in order to create a 'big picture' story of this study. Furthermore, formulating a thick description of the story was an iterative process that required the researcher to reflect on and revisit the research questions and the theoretical framework.

The overall process of data analysis for this study is summarised in Figure 6-3.

Figure 6-3 The process of data analysis in this study



Source: Author

6.4. Summary and conclusions

This chapter has discussed the research method used in this study. It explains how the research objectives can be achieved by adopting two methods: historical research to address the first research question and ethnographic research to address the second research question. The historical research analysis provided tools to explore the historical development of the Islamic microfinance sector in Indonesia, which can be divided into three major periods of development. Details of the development will be discussed in Chapter 7.

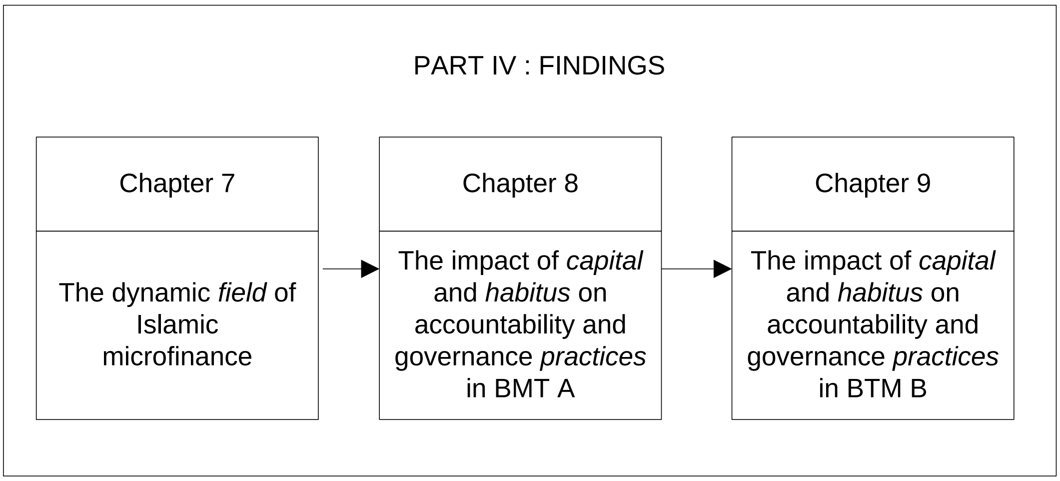
The narrative analysis within the ethnographic research assisted the researcher in transforming the text or raw data of the interview transcript, observation and document resources into explanation. The narrative mode was deemed appropriate to investigate the construction and development of accountability and governance practices within selected IIMFIs (BMT A and BTM B). The findings from this process will be discussed in detail in Chapters 8 and 9. The following part of this study covers discussion of the findings.

PART IV: FINDINGS

This section presents the findings of this study. Chapter 7 addresses the findings related to the first research question which examines the genesis and development of the *field* of Islamic microfinance in Indonesia which are shaped by the prevailing socio-economic and political aspects in Indonesia. According to Bourdieu's metaphor of the game, *field* is the sphere of play which informs the players the specific rules and regulations on how to play and the strategies to adopt to maximize their position in the game.

Following Bourdieu's analogy above, chapter 8 and 9 will discuss two dominant players or social actors in the *field* of Islamic microfinance in Indonesia which is represented by BMT A and BTM B. These two chapters will present the findings related to the second research objective which seeks to investigate how accountability and governance are practiced within BMT A and BTM B. In particular, these two chapters will reveal how *capital* and *habitus* affect accountability and governance practices in the two selected cases. Whilst BMT A has been favoured and closely related to the largest Islamic mass organisation of *Nahdlatul Ulama* (NU), BTM B has grown and developed with support from *Muhammadiyah*, the second biggest Islamic mass organisation in Indonesia as discussed in chapter 4. The belief, custom and religious practices of both organisations are slightly different which result in the distinction on the *habitus* of the two IIMFIs.

In each of the two chapters, the historical background on how the selected organisation entered the *field*, the organisational *habitus* and the accountability and governance practices, will be explained.



CHAPTER 7 THE DYNAMIC *FIELD* OF ISLAMIC MICROFINANCE IN INDONESIA

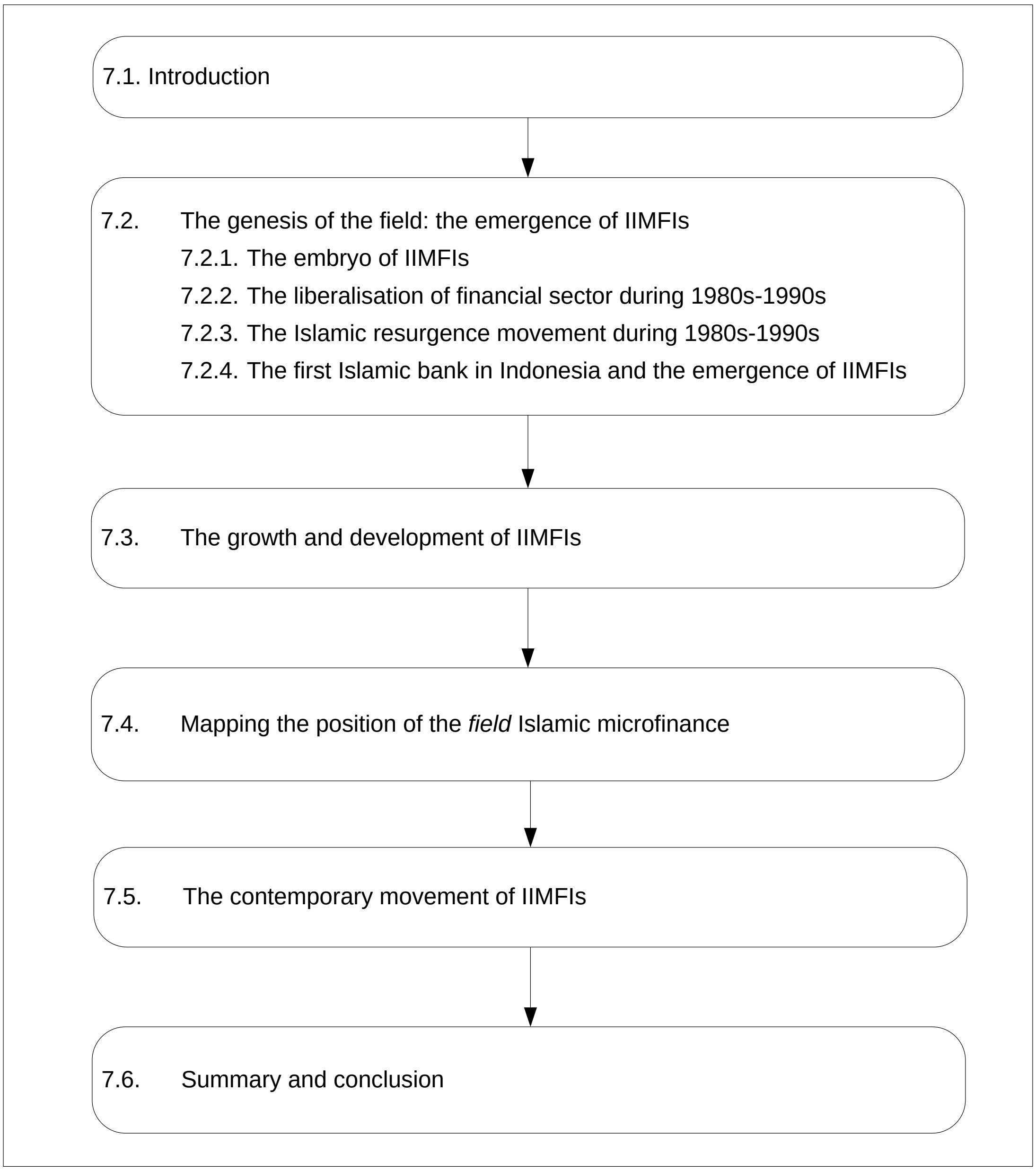
7.1. Introduction

The purpose of this chapter is to present the findings that address the first research objective by examining the historical development of the Islamic microfinance sector in Indonesia; in particular, it aims to explore how the *field* of Islamic microfinance in Indonesia emerged and developed. By reviewing the literature on the history of microfinance initiatives in Indonesia and the Indonesia's economic and political situation, this study has identified a number of important milestones represent the major changes in the *field* of Islamic microfinance in Indonesia.

As suggested by Esposito (2008), the manifestation of Islam in Asia is not only shaped by culture, but also the socio-economic and political structure and, as such, it is important to recognise the context within which the *field* is situated. Therefore, this chapter provides a narrative history of the socio-political situation during the period of the emergence of the IMF sector in Indonesia right up to the present day. Understanding the socio-economic and political history will help to illuminate how the Islamic microfinance emerged and developed over time.

This chapter proceeds as follows. Section 7.2 describes the emergence of the Islamic microfinance sector as a *field* from the Dutch period. It continues discussing the initiative to re-establish Islamic microfinance during 1980-1990, followed by the development of IIMFIs during 1990-2000 and the contemporary movement post 2000. The position of the Islamic microfinance sector within the Islamic financial sector is discussed in section 7.5 and finally, section 7.6 presents a summary of the chapter. The structure of Chapter 7 is illustrated in Figure 7-1.

Figure 7-1 The structure of chapter 7



7.2. The genesis of the *field* : the embryo of IIMFIs

The concept of financial services based on Islamic teaching in Indonesia has a long history. It can be traced back from the Dutch period, but this institution was vanished during the Indonesian independence period. The initiative to re-establish such institution started from 1980, driven by the financial reforms and the Islamic resurgence movement during 1980-1990.

7.2.1. The Dutch period

The roots of financial services based on Islamic teaching in Indonesia can be traced back to the Dutch colonial period. It was an informal organisation started by the headman in the district of Purwokerto, R. Aria Wiraatmadja, as a collection of social funds from mosque congregations, which later became the capital used in setting up the first indigenous and rural bank with the motive of releasing people from the interest strangle of Chinese moneylenders (Steinwand, 2001). As the chairman of ABSINDO (*Asosiasi BMT Seluruh Indonesia* – the Association of Indonesia's IMFIs) explained:

> *"The concept of Islamic financial services in a micro scale had been practiced by R. Aria Wiraatmadja. He placed a charity box in the mosque to collect donations and then utilising it as a loan to help the poor people who lived around the mosque. Unfortunately, he charged interest when administering the loan" (ST 01).*

The mosque funds collected during the Dutch colonial period are known as a *Baitul Maal*, and the formation of such funds were reported only to be in Java and Madura (Fauzia, 2008). The source of funds were not only from donations, but also from service fees such as marriage or *talak* (divorce), inheritance or bequest, and these funds were utilised mainly to cover the operational costs of the mosque and provide welfare to the community (Fauzia, 2008). The rural bank which was founded in

1895 and funded by the funds from the mosque was called *De Purwokertosche Hulp-en Spaarbank der Inlandsche Hoofden*, and it later became *Bank Rakyat Indonesia* (BRI) (Patten, Rosengard & Don E. Johnston, 2001). BRI later became the flagship of rural microfinancing in Indonesia (Seibel, 2005b), and is considered to be the largest and the most successful nationwide rural bank in the world (Robinson, 1992; Patten, Rosengard & Don E. Johnston, 2001).

At almost the same time as the bank of Purwokerto, the Dutch started to establish a credit system in Indonesia. This effort was considered to be part of the Dutch ethical policy in Indonesia (Steinwand, 2001), meant towards improving the welfare of its Indonesian colony. At this time, the economic condition of indigenous people in the East Indies (the designation for Indonesia during the Dutch colonial period) deteriorated following a long period of exploitation (Wie, 2010). Therefore, there was an increase in internal political pressure, primarily from Islamic fundamentalists, and also external pressure from Dutch parliamentarians, which forced the Dutch to consider the welfare of the colony's people (Steinwand, 2001). Furthermore, the Dutch intervened in the rural credit market due to the high dependence of the local rural villagers on Chinese moneylenders, who exploited them by imposing exorbitant interest rates (Steinwand, 2001).

Due to the success of the bank in Purwokerto in helping those who had fallen foul of Chinese moneylenders, De Wolff van Westerrode, the Dutch colonial official (*asisten residen*) in Purwokerto, established the first similar bank in Java in 1903 (Steinwand, 2001). This bank grew significantly, and the Dutch government provided funds to establish similar banks in other places, called the *Volksbank*

(People’s Bank), or *Afdeelingsbank* (District Bank) (Steinwand, 2001). After returning from Europe and visiting the cooperative Raiffeisen banks in Germany, De Wolff established a cooperative rural bank known as *lumbung desa* (Village barn) all over Java and the Madura islands. De Wolff replicated the idea of the *Raifeisen* self-help principle, so that no government funds were utilised as the initial capital. Instead, in order to establish the *lumbung desa*, people were required to retain 40% of *zakah* as seed capital (Steinwand, 2001; Henley, 2007). The *lumbung desa* was managed by a committee comprising of the head of the village, a clerk and a local Islamic religious leader (Henley, 2007).

The main purpose of the *lumbung desa* was to provide loans to people during the time of the rice shortage, which were to be repaid within one month after harvest with an interest rate of about 10% (Steinwand, 2001). The number of *lumbung desa* increased significantly from 300 in 1900 and reached a peak of more than 12,000 in 1910 (Steinwand, 2001). This number then decreased gradually due to a shortage of internal funds, finally forcing the *lumbung desa* to close in 1934 due to rampant fraud and embezzlement of funds by the management (Steinwand, 2001). A few decades later, the effort to establish Islamic financial institutions reappeared, which was driven by the liberalisation within the financial sector and an awakening of Islamic movements, which will be discussed in the next sections.

7.2.2. Post 1980-1990: the initiative to establish Islamic financial institutions

7.2.2.1. The liberalisation of financial sector

A restructuring of the financial sector took place during the latter part of the 1960s following the economic deterioration after a tumultuous period in Indonesia’s history, which culminated in the changeover of leadership from President Sukarno to President Suharto. The new government had to adopt a stabilisation policy to reduce hyperinflation, as well as implement a rehabilitation policy to restore food production and distribution infrastructures (Liddle, 1991). Since the financial system was considered to be the critical element of economic development (Cole & Slade, 1998), the stabilisation policy required the Indonesian government to reform its financial sector. This reformation paved the way for the emergence of rural banking and the introduction of the rural credit program at the beginning of the 1970s.

As part of the financial reform, a series of regulations, namely Act No. 14/1967, concerning the principle of Indonesia's banking, and Act No. 13/1968, concerning Indonesia's Central Bank, were promulgated (Steinwand, 2001). The Acts formulated the design of the Indonesian banking system and the Central Bank was set up to undertake monetary policy and act as the coordinating authority that would guide and supervise all banks. The regulation also revoked the sole bank system that resulted from the merger of all state-owned banks and the Dutch-nationalised banks. In parallel with the political policy which favoured national stability by limiting political activity outside of the government's control (Mackie, 1999), the government strictly prohibited the establishment of new private commercial banks (Sato, 2005). As a consequence, the banking sector was dominated by state-owned banks, which were strictly controlled by the government, and regarded as an extension of the government. The central banking authority set up the fixed lending rate, assigned the target sector to be funded, and channelled a highly subsidised credit for agriculture which placed a burden on the government's budget (Steinwand, 2001).

In 1982, Indonesia encountered problems with its balance of payment after the collapse of oil prices in the world market, and consequently asked for outside assistance from the International Monetary Fund (IMF) (Omori, 2007). Since the petroleum sector had previously contributed almost two-thirds of the government's revenue (Hill, 1996), the decline in the price of oil caused the government's deficit to increase substantially. In order to stop this deficit, the IMF prescribed that the government should minimise its dependency on petroleum revenue and adopt a market-orientated approach, which in turn led to the implementation of the financial liberalisation policy (Robinson & Rosser, 1998). A summary of the three major financial reforms imposed during the period of 1983–1992 (Agung, 1998) is as follows: the June 1983 reforms halted the era of state-bank domination and subsidised credit; the October 1988 package removed the barrier preventing competition within the banking sector; and the 1992 Banking Law resulted in the recognition of two types of banks – commercial and rural.

Following the IMF's recommendations, the government launched the first financial reforms in June 1983, which removed the credit ceiling for all banks, thus permitting them to determine the deposit and lending rates (Sato, 2005; McLeod, 2007). The reforms were aimed at expanding and mobilising domestic capital, as well as attracting foreign investors to invest in Indonesia (Resosudarmo & Kuncoro, 2006). The 1983 financial reform apparently affected the operation of rural banks, as the *Bank Rakyat Indonesia* (BRI) was no longer channelling the subsidised agricultural credit from the government (Sato, 2005). The reform required BRI to become a profitable bank. Therefore, the subsidised credit, namely *Bimbingan Massal* (BIMAS), was phased out and replaced with a new program called *Kredit Umum*

Pedesaan or KUPEDES (General Rural Credit), which was introduced in 1984 and still exists to the present day (Robinson, 2002). By the end of the BIMAS era, it was reported that BRI succeeded in establishing a network of 3,626 village units throughout the country (Robinson, 2002), which became the backbone of KUPEDES's success. So, it is not surprising that Indonesia was recorded as having the most successful nationwide rural banking system of any developing country (Robinson, 2002). In other words, the 1983 deregulation brought Indonesia into financial liberation by gradually eliminating government intervention in the financial sector (Lapenu, 2001).

The second financial reform, known as *Paket Oktober* or Pakto 88 (October Package), was launched in 1988 and encouraged the development of rural banking (Robinson, 2002). Prior to 1988, the establishment of a new bank was strictly prohibited but Pakto 88 provided the opportunity for banks to expand their activities, since the entry barrier for new domestic and foreign banks was removed and the bank specialities were abolished (Sato, 2005). As a result, state and commercial banks started to set up their branches and widened their services in order to reach rural areas. Moreover, new privately-owned micro-banks, known as *Bank Perkreditan Rakyat* (BPR – People's Credit Bank), began to emerge, since the minimum capital requirement was only IDR 100 million (equal to GBP 5,075: 1 GBP = IDR 19,702; 1st May 2015) (Ismawan, 2006). Pakto 88 resulted in the burgeoning of rural micro-banks, and it can therefore be considered to be the inception of microfinance regulation in Indonesia.

The third financial reform was the introduction of Act Number 7/1992, which concerned Banking Law. The reason for the enactment was that the previous Act, 13/1968, was insufficient when it came to providing a legal framework that would accommodate the rapid development of the banking sector (Bennett, 1995-1996). Act 7/1992 marked the culmination of the financial liberation era, since it not only stipulated articles that facilitated the entry of foreign banks and permitted banks to issue stocks to the public but, most importantly, it also increased the existence of the two types of banks: commercial and rural (Chou, 1999; Asian Development Bank, 2009). This banking law strengthened the position of rural banks by enabling the numerous non-bank institutions that had existed since the 1960s to become rural banks, they operated in sub-district areas with a certain paid-up capital as stipulated in *Pakto 88* (Holloh, 2001). At this stage, the financial services institution began to operate on a micro-scale and reach vast rural areas throughout Indonesia. This development of the banking sector was seized as an opportunity by Islamic scholars to enforce the establishment of a financial sector based on Islamic teaching.

7.2.2.2. The Islamic resurgence movement

Islam had played a significant role in shaping Indonesia's political landscape (Pringle, 2010). However, the relationship between Islam and the government had its ups and downs. During President Sukarno's era, the Islamic separatist movement attempted to establish Indonesia's Islamic state, with the separatists' efforts eventually ending unsuccessfully (Tamara, 1986; Bruinessen, 2002; Elson & Formichi, 2011), serving only to leave Islam with a negative image. Learning from his predecessor, President Suharto imposed a policy to curtail Islamic political power, which was seen to potentially imperil the unity of the state, limiting its activities to only religious rituals and in the cultural and social domain. This policy was aimed at controlling the Islamic movement, and it was manifested systematically, as follows.

First, the utilisation of Islamic attributes in the public space was strictly prohibited, and might be suspected as a manifestation of Islamic extremism, and thus be seen as being against government policy. Second, The Ministry of Religious Affairs was set up to control the Islamic boarding schools and to supervise *dakwah* activities (propagation preaching of Islam) and sermons during Friday prayers, as part of the early prevention of the re-emergence of radical Islam. Third, the power of *ulama* was domesticated by establishing the *Majelis Ulama Indonesia* (MUI – the Council of Indonesian Religious Scholars), whose authority was limited to the issuance of *fatawa* (legal pronouncements in Islam) in favour of the government, and acting as the mediator in the delivery of the government's development programs to the Muslim community (Ichwan, 2005).

Islam situation in Indonesia during the 1980s was in stark contrast to that in other countries. The triumph of the Iran Revolution in 1979, which was perceived as being the beginning of the Islamic Resurgence, imbued Muslim activists throughout the world to return to Islam as a way of life (Esposito, 1999). These activists succeeded in enforcing the application of Islamic Law in Pakistan and Libya, and not only supported separatist movements in the Philippines, but also fought the Soviet invasion of Afghanistan (Rosyad, 1995). Influenced by such movements, the phenomena of Islamic resurgence began to emerge in Indonesia, initiated by young intellectual Muslims in the campus of *Institute Teknologi Bandung* (ITB – Bandung

Institute of Technology). A group of students has organised Islamic activities in the campus mosque, such as intensive discussions about Islam, and a number of female students began to wear hijabs (veil and headscarf) in public. These activities were conducted through the underground movement, because the government banned all student activities involving politics after the 1977 student demonstration to protest against the government's policy turned violent (Rosyad, 1995). However, this movement was contagious, and it spread to other campuses.

A few years later, this movement brought a change in the social and political situation of Islam in Indonesia, as a number of the activists occupied central positions in the bureaucracy. A major achievement by the group was the establishment of the association of Muslim intellectuals known as *Ikatan Cendekiawan Muslim Indonesia* (ICMI – The Association of Indonesian Muslim Intellectuals) in December 1990, which was facilitated by the Minister of Science and Technology, Habibie, who had a very long and close relationship with President Suharto.

ICMI played a significant role in encouraging Islam as a way of life in Indonesia by endorsing the Islamic national newspaper, *Republika*, to broaden the dissemination of *dakwah* articles. In its development, and supported by ICMI, *Republika* established a charity section called *Dompet Dhuafa* (DD) in 1993. Besides raising money for charity, DD also aimed to seek reform in the practice of Islamic philanthropy, particularly the *zakah* institution, by focusing on modernising its management and diversification program (Fauzia, 2008). DD called upon the *zakah* institutions to improve their accountability and transparency in managing *zakah* by publishing financial reports. Moreover, DD developed a diversification program in utilising *zakah* funds in more effective ways; instead of giving rice or cash to deserving beneficiaries as in the past, it now developed a wide range of social projects such as establishing education facilities and health services, and empowered people by supporting the establishment of financial institutions aimed at helping the poor gain access to financial capital and overcoming poverty.

The major landmark for the ICMI (supported by the MUI) was the establishment of the first interest-free bank in Indonesia. The initiative to establish Islamic banks in Indonesia emerged from the recommendation of a workshop organised by MUI in 1990 on interest and banking from an Islamic perspective (Choiruzzad & Nugroho, 2013). The workshop was held to facilitate the ensuing debate about the permissibility of interest among the two largest Islamic mass organisations: NU and *Muhammadiyah*. From the *Muhammadiyah's* perspective, interest is considered as permissible (*halal*) if it is taken legally and in accordance with government regulation. Conversely, if interest is taken illegally by a loan shark, then it is considered as usury (*riba*) and should be prohibited (Choiruzzad & Nugroho, 2013). While *Muhammadiyah* has a unified view on the permissibility of interest, the opinion of Islamic scholars in NU was divided into three groups (Choiruzzad & Nugroho, 2013). The first group argued that interest is strictly prohibited (*haram*) because the lender takes benefits or return from the loan, and this meets the definition of *riba*. The second group argued that interest is *halal*, as long as there are no conditions attached when transactions occurred. The third group viewed that the permissibility of interest as being doubtful (*syubhat*), since the scholars had different views on the issue.

Abdurrahman Wahid (a grandson of the founder of NU) who is one of the NU scholars who legitimises interest, established an NU-owned bank called *Bank Summa* aimed at providing credit to small-business owners, especially NU followers, who lived in the rural areas. Supported by a Christian Chinese businessman, William Soeryadjaya, the first NU-Summa bank was established in March 1990 with the agreement to establish at least 2,000 branches throughout Indonesia (Bruinessen, 1996a).

The banks operated on an interest basis, and after operating for just two years, Bank Summa was forced to close, some attributing it to political reasons while others claimed it to be due to mismanagement (Choiruzzad & Nugroho, 2013). However, the scholars of NU and *Muhammadiyah* who prohibited interest agreed to realise the idea of an Islamic banking sector in Indonesia, and they formed a working group to conduct feasibility studies. Through intensive lobbying by the ICMI's leaders, Suharto finally gave his blessing for the establishment of an Islamic bank, provided the word 'Islam' was dropped and the name *Bank Muamalat Indonesia* (BMI) was chosen.

7.3. Post 1990-2000: the emergence and development of IIMFIs

7.3.1. The establishment of the first Islamic bank and the emergence of IIMFIs

After a long process, the establishment of BMI was realised in November 1991. However, due to the absence of a legal basis for its operation, BMI was not able to operate immediately. Hence, the MUI and ICMI continued to pressure the government to enact regulation to enable the operation of BMI and, finally, Act Number 7/1992 concerning banking law was enacted, which acknowledged the operation of a dual banking system: interest-based and profit sharing-based (Kasri & Kassim, 2009). Two months later in May 1992, BMI began to operate. The lack of technical guidelines or operational procedures for Islamic banks (Holloh, 2001), caused the growth of the Islamic banking sector to come to a standstill during the period of 1992–1998, with just 10 offices in 1998. The number of Islamic banks during the period of 1992–2013 is illustrated in Table 7-1.

Table 7-1 The number of Islamic banks in Indonesia 1992–June 2013

Year	Islamic commercial bank		Islamic windows		Islamic rural banks		Total offices
	Number of banks	Number of offices	Number of banks	Number of offices	Number of banks	Number of offices	
1992	1	1	0	0	9	9	10
1999	2	41	1	2	79	79	122
2000	2	57	3	7	79	79	146
2001	2	86	3	15	81	81	182
2002	2	115	6	31	83	83	229
2003	2	209	8	56	84	84	349
2004	3	266	15	89	88	88	443
2005	3	300	19	154	92	92	546
2006	3	348	19	177	105	105	630
2007	3	401	26	196	114	185	782
2008	5	581	27	241	131	202	1,024
2009	6	711	25	287	138	225	1,223
2010	11	1,215	23	262	150	286	1,763
2011	11	1,401	24	336	155	364	2,101
2012	11	1,745	24	517	158	401	2,663
June 2013	11	1,887	24	533	159	397	2,817

Source: Islamic Banking Statistics, Bank Indonesia 1999–June 2013

The interview with the first director of BMI (ST 01) confirmed that the tight banking regulation and bureaucracy did not provide enough space for BMI to rapidly increase the number of branches. As a consequence, there was an extensive discrepancy between Muslim enthusiasm for an Islamic bank and the BMI's capacity to reach rural areas, as BMI could only operate in Jakarta and a few other big cities. The only possibility for bolstering the growth of the Islamic bank was by establishing *Bank Perkreditan Rakyat* (BPR) or People's Credit Bank. Nevertheless, the minimum paid-in capital required by the Central Bank for the establishment was still high and the administrative process was quite long. ICMI, as one of the BMI's founders, organised a series of discussions to seek the most suitable formula for meeting the demand for financial services based on *shari'ah* whilst being capable of providing the initial capital. Finally, it was agreed that the most appropriate choice forward is in the form of BMT. As discussed in Chapter 4, BMT is a generic name for IMFIs in Indonesia (Seibel & Agung, 2005). Therefore, the term 'IIMFI' and 'BMT' will be used interchangeably in this study.

The idea of BMT was not a novel concept; it can be traced back to 1984, when students at the ITB established the *Baitul-Tamwil Teknosa* (Choiruzzad & Nugroho, 2013) as a trial project to implement financial services based on *shari'ah* on a micro-scale (Rosyad, 1995). No-one knows when or why *Teknosa* was dissolved. However, the spirit to implement *shari'ah* principle in business by young students who had the opportunity to study this through a short-course at the *Teknosa*, was high. The alumni of such training were inspired to established similar institutions in their own hometowns. As the manager of one BMT explained:

> *"I was really impressed with Teknosa. It inspired me to apply Islamic values in real life –actually doing so was only a dream, until 10 years later when I was trusted to manage a small fund, and I started to operate financial institution based on shari'ah" (WR 01).*

Years later, a cooperative based on profit-sharing, known as *Ridha Gusti*, emerged in Jakarta (Perhimpunan BMT Indonesia, 2012). However, there is no literature documenting its history or achievements, or the reasons as to why it was dissolved. In 1992), a similar organisation known as *Bina Insan Kamil*, was set up. This organisation was founded by Zainal Muttaqien, a young Islamic activist who was concerned with helping people free themselves from the grip of moneylenders using the social funds from *Baitul Maal* (Antonio, 2008). With the help of Aries Muftie, a young banker and fellow Islamic activist who was concerned with the sustainability of the institution, the concept of the Islamic microfinance institution was finalised by combining *Baitul Maal* with *Baitul Tamwil* (which became *Baitul Maal wat Tamwil* – BMT). However, the sustainability of an institution funded by social fund was questionable in the long-term, hence, such funding should be supported by commercial activities, which would enable the organisation to generate some profit to then refinance its own social activities (ST 01).

The BMT *Bina Insan Kamil* grew rapidly as a result of intensive *dakwah* by its founders. Thousands of people conducted financial transactions, which caused the institution's assets to increase significantly within a short period (Hamdan, 2011) – an exceptional achievement compared to that of the Islamic Bank which remained stagnant due to rigid banking regulations and the absence of a supporting infrastructure suitable for Islamic financial institutions. Hence, learning from the success story of *Bina Insan Kamil*, the BMT model was perceived as an alternative way of meeting the high demand for financial services based on *shari'ah principle*. Therefore, a number of institutions began to replicate *Bina Insan Kamil*'s model in other places.

7.3.2. The growth and development of IIMFIs

The BMT or IIMFI sector had grown significantly during the period of 1990–2000, due to the groundwork of a number of institutions such as P3UK (*Pusat Pengkajian dan Pengembangan Usaha Kecil,* or Center of Micro-Business Assessment and Development), PINBUK, *Dompet Dhuafa* and *Muhammadiyah,* as well as other individual and collective initiatives aimed at establishing IIMFIs. P3UK was established by a group of Islamic activists who were official members of ICMI with the aim:

> *" to provide basic training in areas such as fundraising, distributing and administering funds, marketing, and bookkeeping, to help people establish their own IIMFIs" (ST 01).*

Many people attended the short training sessions. P3UK was successful in engendering the increase of IIMFIs but due to lack of support from the government, P3UK was unable to develop IIMFIs throughout Indonesia. To bolster the growth of IIMFIs, ICMI, established a foundation called PINBUK (*Pusat Inkubasi Bisnis Usaha Kecil* – The Centre for Small Business Incubation) in 1995, supported by BMI (Hamdan, 2011). The aim of PINBUK was to socialise the Islamic financial institutions by establishing IIMFIs through the network of ICMIs throughout Indonesia. The chairman of PINBUK confirmed:

> *"As an organisation initiated by ICMI – a privileged organisation during Suharto's era – it was not surprising that PINBUK obtained full support from the government, including funding. With the support from ICMI's network throughout Indonesia, PINBUK offices could be found at both national and provincial levels" (ST 03).*

The full support from the government for the establishment of IIMFIs was represented by the inauguration of the movement for the formation of IIMFIs in

Indonesia in late 1995 by President Suharto (Holloh, 2001). Hence, it was not surprising that the growth of IIMFIs during the period 1990–1995 was exceptional, from just 300 to more than 2,500 by 2000 (Seibel, 2004), as illustrated in Table 7-2. This number was consistent with P3UK's claim that it had trained more than 3,000 people during the period of 1994–1997 and that most of the participants started to set up IIMFIs (Hamdan, 2011).

Table 7-2 The number of IIMFIs 1990-2003

No.	Phase	Period	Number of IIMFIs
1	Initial growth	1990–1995	300
2	Rapid growth promoted by PINBUK	1996	700
		1997	1,501
		June 1998	2,470
3	Slowing down of growth	2000	2,938
4	Stagnation and decline	2003	2,856

Source: Seibel (2004:6)

The rapid growth of IIMFIs was also as a result of the effort of the *Dompet Dhuafa* (The Poor Pocket) Foundation, as discussed in previous section. The Foundation aimed to collect *zakah* (religious tax) from the employees of the Islamic national newspaper *Republika*, and utilise it to empower the needy through a wide range of productive activities such as providing scholarships and training programs and economic empowerments (Sakai, 2010). With regards to empowering the economy of the *ummah*, the Foundation launched a program to establish 1001 IIMFIs and rural Islamic banks (Choiruzzad & Nugroho, 2013), and during the period 1993–2008, the Foundation reported that it had established more than 500 IIMFIs throughout Indonesia. Another institution that helped the growth of IIMFIs is the *Muhammadiyah*, as discussed in Chapter 4 through the *Yayasan Baitul Maal Muhammadiyah*, it actively assisted the establishment of BTM (*Baitul Tamwil Muhammadiyah*) in several provinces (WR 01).

Besides these institutions, hundreds of IIMFIs were also set up independently by individuals (Perhimpunan BMT Indonesia, 2012). The establishment of most IIMFIs, which ensued almost simultaneously, then led to the tremendous growth of IIMFIs during the mid-1990s. Instead of declaring themselves as a financial institution, these IIMFIs assigned themselves as *dakwah* institutes, whose aim was to uphold Islamic teaching and Islamic economics based on *shari'ah,* as well as to empower poor people. BMTs or IIMFIs are today considered as an integral part of the Islamic financial sector in Indonesia.

7.4. Post 2000: the contemporary movement of IIMFIs

The term 'movement' refers to a collective action in a society that focuses on a specific social or political issue (Porta & Diani, 2006). Driven by similar problems they each encountered, a number of IIMFIs took certain actions that can be classified as the IIMFI movement.

The first IIMFI movement was the establishment of INKOPSYAH (*Induk Koperasi Syariah* a secondary cooperative at a national level) with BMTs as its members (ST 02). As a secondary cooperative, the main goal of INKOPSYAH was to provide savings and loan services for all IIMFI members. However, in its development, the role of INKOPSYAH shifted to being the liquidity provider for its members. The membership system was based on a voluntary-system and by the end of 2012, they claimed to have 385 members (INKOPSYAH BMT, 2011).

The second movement of IIMFIs took place at the beginning of 2000, and was driven by the loss of IIMFIs' legal status after the termination of the PHBK project and link between banks and self-help groups in 1999. The implication was that IIMFIs were forced to transform their legal status to that of a cooperative. At the beginning, the IIMFIs were at a crossroad (ST 01); on one hand, most of the IIMFIs initiators, who were considered as fundamentalist Muslims, argued that IIMFIs should have their own legal status, different from that of a cooperative. However, the Indonesian legal structure did not accommodate the necessity for the self-legal status of IIMFIs. In this situation, the IIMFIs' position was divided into two groups: a group that voluntarily registered its institution with the Ministry of Cooperatives, and another group persisted in defending its status quo without legal status. A few years later, a number of IIMFIs that persisted on keeping their status quo were forced to terminate their operations due to the accusation of being illegal institutions in mobilising and distributing funds from society. Surprisingly, the majority of the IMFIs that were forced to close were those financial institutions that were growing with outstanding financial performance (ST 01)

On the other hand, the IIMFIs that had the legal status of being cooperatives were able to continue their operations but faced other issues. They suffered from liquidity problems and a shortage of funds due to the difficulties in mobilising savings following the loss of public trust toward IIMFIs. Furthermore, there was no access to financial support from the government or the financial market. Driven by this issue, the third movement emerged.

The third movement was the rise in awareness to establish an association of IIMFIs, as peer support and mutual help among members. Local associations started in some regions in Central Java such as Surakarta, Wonosobo and Klaten (Perhimpunan

BMT Indonesia, 2012). The mutual benefits from joining the association encouraged them to establish such associations at the national level. Initiated by 12 of the IMFIs in June 2005, the first national level of IMFIs was then founded and named the BMT Centre, which was then later changed into *Perhimpunan* BMT/PBMT (BMT's association) with the aim of bolstering the development of the IMFI sector into a robust and sturdy one (BMT Center, 2013). A few months later, another IIMFI association was established following the national congress of IIMFIs, which was held in December 2005. The congress was attended by 600 participants from across Indonesia, who agreed to establish the association of IIMFIs, namely ABSINDO, aimed to reinforce and empower IIMFIs as a professional financial service provider based on *shari'ah* (Muftie, 2010). The forum also stated that the purpose of ABSINDO is to implement programs that focused on advocating the transformation of IIMFIs' legal status as a cooperative, as well as inviting others to join the association.

There are no obvious differences between the two associations of IIMFIs (ABSINDO and PBMT) in terms of missions, programs or regions. Moreover, the membership was voluntary, and IIMFIs were free to determine their involvement or abstention in the particular association. As a consequence, both associations, in some ways, encountered overlapping activities, members as well as management (ST 01). By September 2012, PBMT claimed to have 206 members (Perhimpunan BMT Indonesia, 2012), while ABSINDO recorded 500 IMFIs, many of which were members of two the associations (ST 02).

The emergence of IIMFI associations such as INKOPSYAH, PBMT and ABSINDO, which were regarded as the IIMFI movement, were the corollary of the absence of the government’s support of the Islamic microfinance sector (ST 01). Since no regulation or supervisory institutions were provided by the government, these associations became self-regulating organisations for their members, assigning a set of regulations for their members, which determined the minimum standard of financial performance level, developed programs for capacity building and provided liquidity funds if needed (Muftie, 2010).

Furthermore, both associations were likely to be in competition for acquiring more members and thus provide them with an excellent service. In order to strengthen its position, PBMT set up the blueprint of BMT 2020 as the policy guidance for its members to accelerate their growth and development (Perhimpunan BMT Indonesia, 2010). Hence, in order to achieve their goals and provide full support to their members, PBMT established subsidiaries such as PBMT Ventura, in order to provide liquidity, PBMT Travel, in order to provide pilgrim services, PBMT Institute for Capacity Building, PBMT *Taawun,* in order to provide insurance services, and *Baitul Maal* PBMT, in order to collect and distribute *zakah* (Perhimpunan BMT Indonesia, 2012).

On the other hand, ABSINDO had an initiative to establish the apex organisation, which functioned as a self-regulatory organisation, which specialised in dealing with mismatch in liquidity, settlement and payment systems, savings guarantees, linkage programs and management services, as well as monitoring and evaluation (Marguerite, 2013). The apex organisation was intended to function also as the central bank , which would enable it to monitor financial transactions and act as the deposit insurance cooperation that protected the depositor's interests as well as those of the financial service authority, which had the power to issue regulations, audit and investigate fraud (ST 02). In order to do so, ABSINDO was required to set up the national network of IIMFIs through building the information technology infrastructure as its backbone, and set the standard of operating and monitoring systems (ST 01).

Whilst those associations were competing in acquiring members and providing unique services, both persistently encouraged the government to accommodate the necessity for the legal assurance and specific regulations for IMFIs (ST 01). The draft of the Microfinance Act was introduced in 2003, and after some time, Act No. 1/2013, concerning microfinance institutions, was introduced in January 2013 (Miko, 2013). The Act strictly obliged all microfinance institutions to specify their legal status, whether cooperative or limited company, and stipulated that microfinance institutions would be under the supervision of *Otoritas Jasa Keuangan* (OJK – the Indonesian Financial Services Authority).

However, this supervision was criticised, as there would be overlapping mechanisms due to the fact that the legal status of the majority of IIMFIs was that of the cooperative, which meant that they were required to conform to the Cooperative Act (Pratama, 2013). Moreover, the OJK would not start operating until 2015, and it is still establishing its operating procedures and infrastructures, as well as still formulating its supervisory mechanisms (Pradiptyo, Sahadewo, Sasmitasiwi, Rokhim, Ulpah & Faradynawati, 2012). Therefore, the regulation and supervision system for IMFIs has not yet been established, as the authority requires a survey to be conducted in order to comprehend the nature of its business (Bratadharma, 2013). Hence, these IIMFI associations play a pivotal role in extending the interests of their members.

7.5. Mapping the position of the *field* of Islamic microfinance

Seibel (2004) observed that Indonesia possessed the greatest diversity of microfinance infrastructure in the world. Compared to other countries, the majority of microfinance institutions in Indonesia operate in urban and peri-urban areas (Seibel, 2008). As Gonzales-Vega and Chaves observe:

> *"Indonesia has been the world's largest laboratory on rural financial market experiments [...] Valuable lessons have been embedded in the variegated experience of Indonesia's rural financial market, along a rich continuum of shades and shapes" (cited by Steinwand, 2001:14)*

In line with the statement above, Holloh (2001) observed that the microfinance sector in Indonesia encompasses a high diversity of institutions, services, programs and target groups, as well as different legal and regulatory frameworks. In general, the Islamic microfinance institutions can be categorised as being formal, semiformal and informal (Holloh, 1998). 'Formal' refers to state, commercial and rural banks that provide financial intermediaries on a micro-scale and are subject to banking regulation and supervision from the Central Bank of Indonesia. There are two types of Islamic commercial banks: full-pledge, which were established and developed to fully follow the *shari'ah* principle, and the window-system, being a division of a conventional bank that operates under *shari'ah* principle. Rural banks, established by Pakto 88 also belong to the category of formal Islamic financial institution. Similar to commercial banks, rural banks are subject to banking regulations and the Central Bank's supervision. They are allowed to borrow and lend money, but do not have access to the payment system.

The regulations pertaining specifically to Islamic financial institutions in Indonesia were issued 16 years after the establishment of the first Islamic Bank, through Act No. 21/2008, which concerns *shari'ah* banking. Prior to the Act, a separate Islamic Banking Law had not existed. The legal basis for the establishment of BMI was the provision in Act No. 7/1992 concerning the Principle of Banking, which defines that "profit sharing" is applicable for banking operations. There were no regulations related to the operations, therefore due to a lack of regulatory frameworks, the Islamic banking sector failed to meet the demand for Islamic financial institutions in Indonesia, as expected.

The acknowledgment of the existence of Islamic banks was only realised after the financial crisis of 1997–1998 that brought Indonesia's banking system to crisis and caused the collapse of a number of banks (Laeven & Valencia, 2008). The financial reforms that focused on prudential banking were established (Sato, 2005) by the introduction of Act No. 10/1998, which concerned the Principles of Banking, and the Act No. 23/1999, which concerned the Central Bank. Act 10/1998 states firmly that commercial banks can operate using one of two methods: interest-based or *shari'ah*-based. The Act also provides permission for conventional banks to open *shari'ah* units in order to boost the development of Islamic financial institutions.

The importance of Islamic banks was strengthened by the introduction of Act No. 23/1999, which mandates the Indonesian Central Bank to regulate and supervise Islamic banks in Indonesia. Following the Act, a set of regulations related to the operations of Islamic banks was established through the regulation of the Bank of Indonesia and the decision of the Governor of the Bank of Indonesia regarding aspects such as the products offered by Islamic banks, the members of the *shari'ah* supervisory board and type of financial contracts offered.

The second type of Islamic financial institution is non-bank or semi-formal, also known as BMT or IIMFI. Historically, when the IIMFIs were established, they had no legal status. Since they encouraged their members to have savings and in order to prevent the allegation of illegal practice, PINBUK established an agreement with the Central Bank to provide training programs and assist in the establishment of IIMFIs, while the Bank of Indonesia would provide a legal status and certificate of operation as the PHBK project (*Proyek Hubungan Bank dan Kelompok Swadaya Masyarakat* – Project Linking Bank and Self-Help Group).

> *"This was due to the fact that according to law, the type of institution permitted to mobilise funds from society were limited to only banks and cooperatives" (ST 01).*

However, the project was legally suspended following the enactment of Central Bank Act No. 23/1999, which abolished the role of Bank of Indonesia as an agent of development, and restored its main task of dealing with monetary affairs. The impact of the termination of PHBK was described by the chairman of ABSINDO – the association of BMT, as follows:

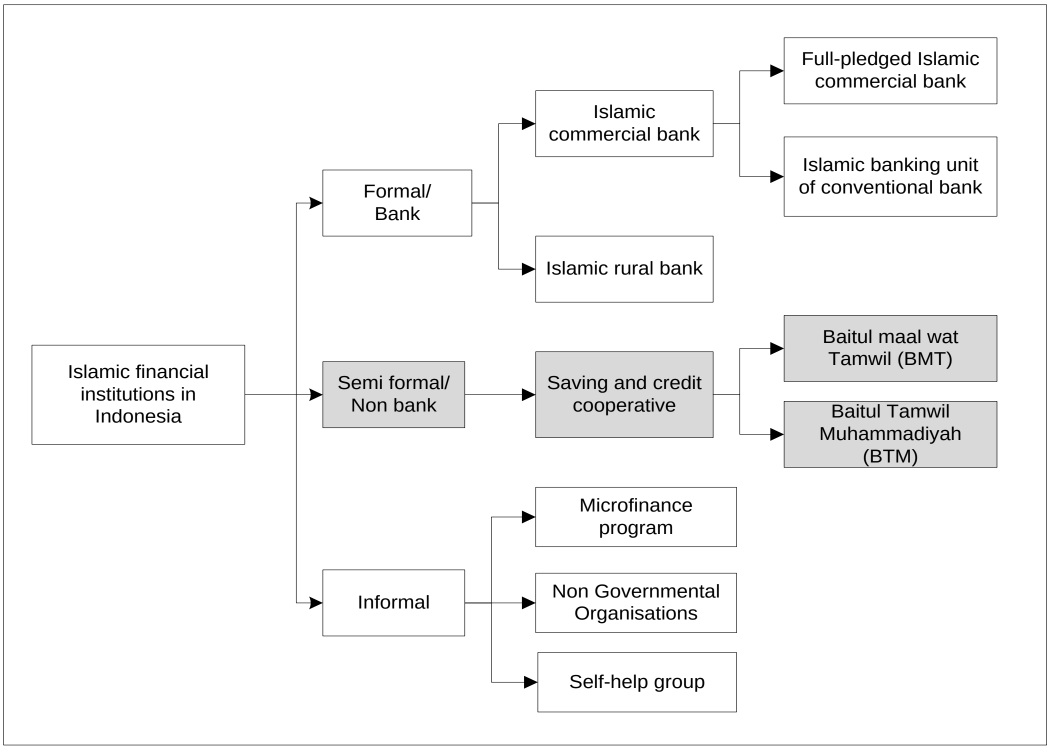
> *"Following the abolition of the PHBK project in 1999, IMFIs suffered from their legal status and accusations of them being illegal institutions. Moreover, their staff were accused of embezzlement. As a result, many IMFIs had to cease operations due to either fear of opening their offices or a lack of staff available to continue the operations" (ST 01).*

Many self-help groups were also phased-out due to the absence of subsidised funds from the government, the failure to mobilise a substantial amount of savings, and high operational costs. In order to respond to this situation, PINBUK then sought the most appropriate legal umbrella for the IIMFIs by involving some of the government institutions (ST 03). Facilitated by the Indonesia's Ministry of Cooperative, the outcome of the discussions was that IIMFIs would be able to choose their legal status from one of two options: as limited company of a rural bank or as a cooperative. Although IIMFIs have distinctive features and cannot be fully categorised as a cooperative (Wahyuni, 2008), IIMFs were recommended to choose to be a cooperative as no other suitable legal framework was available. Moreover, the majority of IIMFIs had not fulfilled the minimum requirement to become a rural bank, so they had no choice but to register as a cooperative. Therefore, the majority of IIMFIs are registered with the Ministry of Cooperative and Small Enterprise, and are subject to the same rules as cooperatives.

The third type of Islamic financial institution is informal which consists of financial services provided by individuals or organisations that operate under regulation and supervision from state agencies. The term "microfinance program" refers to several initiative projects introduced by various Indonesian ministries, commercial banks, local governments, or non-governmental organisations with the aim of empowering the poor and eliminating poverty by facilitating financial support (Holloh, 1998).

Most of the microfinance programs were part of the institution's project and only intended to run for a certain period of time. Therefore, some of them were no longer available today. While self-help groups still exist today, they seemed reluctant to transform into formal institutions, and the government could not force them to do so (ST 05). In short, the position of the *field* of IIMFIs within the sector of Islamic financial institutions is illustrated in Figure 7-2.

Figure 7-2 The position of the *field* of IMFIs within the Islamic financial institutions in Indonesia



Source: Author

Due to the rigid legal framework that needs to be followed by formal banks or IIMFIs, such institutions provide a high level of prudential institution and protection for their clients. On the other hand, unless they are registered as a cooperative, the IIMFI will not be under the supervision of the Ministry of Cooperative and Small Enterprise. Therefore, they jointly established the self-regulatory institution in order to overcome the common issues they encountered.

7.6. Summary and conclusion

This chapter has presented the findings that addressed the first research objective of exploring the historical development of the Islamic microfinance sector in Indonesia. The central argument of this chapter is that the *field* of Islamic microfinance is a dynamic arena that is inseparable from its dynamic socio-economic and political context, and has as such been influenced primarily by the series of financial reforms and the Islamic awakening movement that has occurred in Indonesia over recent decades.

Identifying the major changes in the *field* of Islamic microfinance sector, the discussion was divided into four periods, beginning with the Dutch colonial period during which the idea for Islamic microfinance services started to emerge, continuing with the 1980s and 1990s, during which time the idea began to re-emerge, followed by the period 1990–2000, which marked the growth period of IIMFIs, and ending with post 2000, which saw the collective mobilisation of the IIMFI movement. During each period, the socio-political and economic conditions that shaped the changes in financial-sector reform shed light on the first part of the discussion, which continued with a description of some of the milestones of the initiative of IIMFIs. By doing this, the discussion demonstrated the dynamism of the *field* of Islamic microfinance, over time. The periodical development of IIMFIs is illustrated in Figure 7-3.

The first period can be traced back to the Dutch period. Concerned with trying to help the villagers from the ruthless Chinese moneylenders, a headman in the district of Purwokerto in Central Java, R. Aria Wiraatmadja, established an informal institution that provide loans. R. Aria Wiraatmadja used the mosque funds, known as *Baitul Maal, t*o fund this institution, but applied interest to the loan. This institution grew significantly to become BRI, Indonesia's flagship microfinance institution. The Dutch government established a credit system as part of its ethical policy towards Indonesia, and funded Volksbank (People's Bank) at the district level. For the villages, De Wolff van Westerrode established a self-help cooperative, *lumbung desa*, with the initial capital coming from the *zakah* fund. This institution also grew significantly but due to rampant internal fraud, *lumbung desa* was forced to close in 1934.

The second period, 1980–1990, encompassed two significant events: the financial liberalisation and Islamic awakening movements. From the early 1980s, the government encountered financial distress from the decline of oil prices on the international market. The principal recommendation from the IMF was to liberate the competitiveness of the financial sector. Major financial reforms were made during the period of 1983–1992: the June 1983 reform was to discharge the domination of the state bank while, the October 1988 package was to facilitate the establishment of new banks, including rural banks, and the banking law that recognised two banking systems: interest- and profit-sharing based. This reform was seized by the Islamic economic movement in order to boost the establishment of Islamic bank which was established in 1991.

The third period 1990–2000 marked by the emergence of IIMFIs, which were re-introduced to fill the gaps in the demand for Islamic financial institutions and the lack of capacity for Islamic banks to broaden their services to rural areas. Therefore, the model of IIMFIs practised by the *Bina Insan Kamil* has been replicated throughout Indonesia. The IIMFI sector grew significantly during the period of 1995–2000 due to the work of a number of institutions such as P3K, PINBUK and *Muhammadiyah*. At the beginning of 2000, the number of IIMFIs decreased due to either bankruptcy or accusations that they were illegal institutions, which forced them to close.

The discussion around the fourth period, post-2000, examined the collective actions of IIMFIs, which stemmed from the problems they encountered. A number of IIMFIs in Central Java established an association of IIMFIs, namely PBMT, while another group of IIMFIs also established an association called ABSINDO. Due to the lack of regulation and supervision from the government, these associations became self-regulatory institutions for their members. While both associations succeeded in regulating and increasing the financial performance of their members, the government was still required to play a role, since the majority of IIMFIs were not incorporated into any associations. The next two chapters will discuss the accountability and governance practices employed in the selected IIMFIs: BMT A and BTM B. The dynamic nature of Islamic microfinance, which has been discussed in this chapter, to a degree, has influenced the practice of accountability and governance within the IIMFIs.

Figure 7-3 The periodisation of the development of IIMFIs

	The embryo of financial services based on Islamic teaching	Initiative for Islamic financial institutions	The emergence and growth period of Islamic microfinance institutions	The collective movement period
Period	The Dutch period	Post 1980 - 1990	Post 1990 - 2000	Post 2000 - present
Socio-economic and political situation	• Economic condition was deteriorated after a long period of exploitation • 1901 : The Dutch started to implement ethical policy toward Indonesia	• 1980s-1990 : the Islamic resurgence : • 1990 : The establishment of ICMI • 1988 : The iberalisation financial sector through *Paket Oktober* (October Package)	• 1991 : the establishment of the first Islamic Bank in Indonesia, Bank Muamalat Indonesia • 1992 : Banking Law 7/1992 → recognized profit-sharing system • 1992 :Bank Muamalat Indonesia operated formally • 1997-1998 : financial crisis and banking collapse • 1998 : Banking Law10/1998 → dual banking system • 1999 : Central Bank Law 23/ 1999 → Islamic bank under the Central Bank supervision	• 2011 : the enactment of the Act 21/2011 concerning the Financial Service Authority • 2012 : the enactment of the Act 17/2012 concerning the Cooperative • 2013 : the enactment of the Act 1/2013 concerning microfinance institutions
Milestones of rural microfinance	• 1895 : The establishment of the first indigenous and rural bank funded by Baitul Maal • 1903 : the Dutch government established Volksbank (People Bank) • 1900 : De Wolff initiated to establish cooperative rural bank (lumbung desa = village barn)	• By end of 1980s : a pilot project of Islamic microfinance was practiced by youth Muslim in campus ITB, Bandung • 1988 : the permission of private sector to enter the rural bank sector • 1989 : the inception of linkage program (PHBK – link between bank and self-help group)	• 1994 and 1995 : the set up of centre for development of small business → played significant role in establishing IMFs across the country • 1996-1998 : the rapid growth of IMFIs • 1999 : the end of linkage program → IIMFIs lost its legal status	• 2000-2005 : the transformation of legal status of IMFIs into co-operative • 2004 : the provision for the co-operative of Islamic financial service • 2005 : the establishment of IIMFIs associations

Source : author

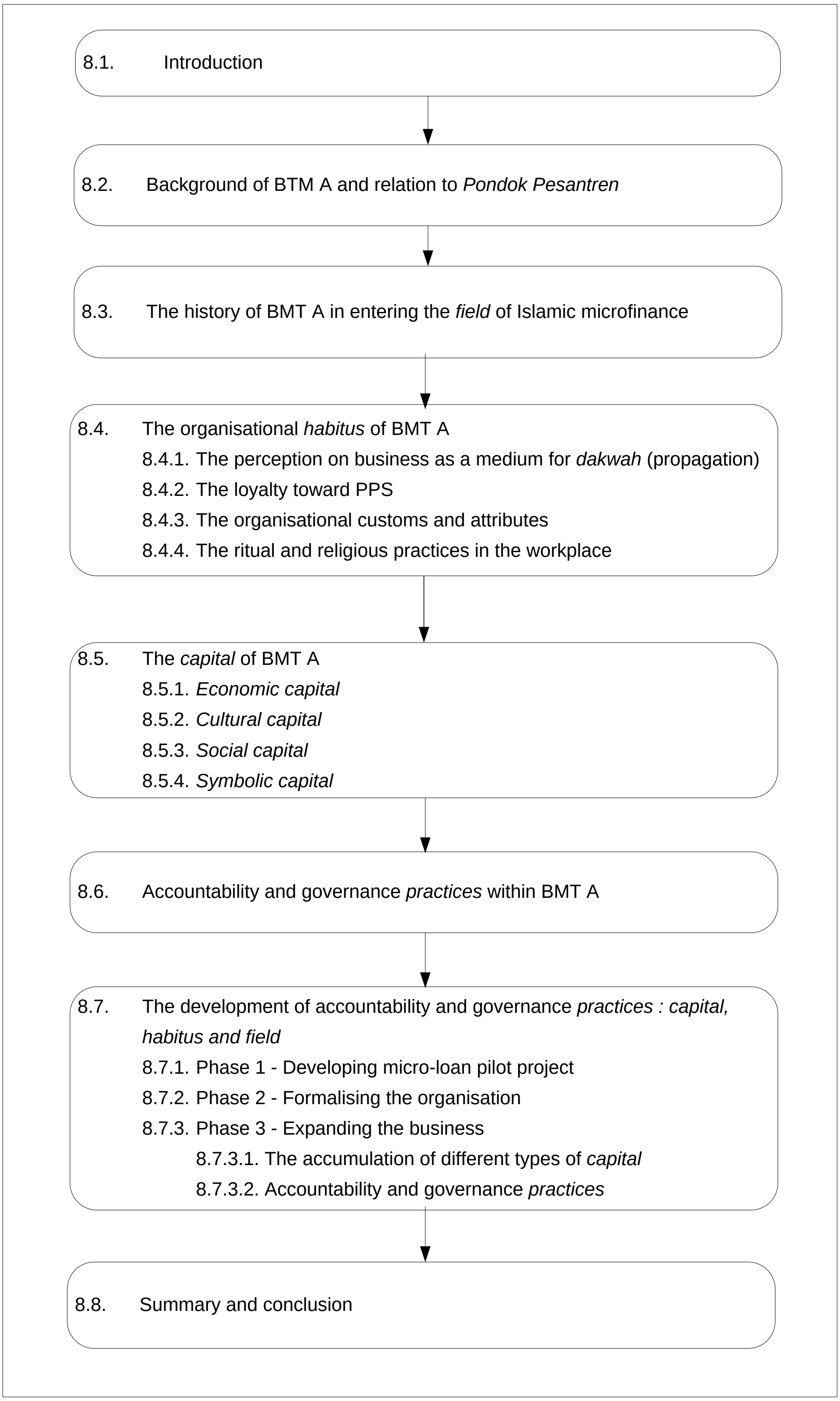
CHAPTER 8 *CAPITAL, HABITUS* AND THEIR INFLUENCE ON ACCOUNTABILITY AND GOVERNANCE *PRACTICES* IN BMT A

8.1. Introduction

The previous chapter discussed the historical development and the dynamic *field* of Islamic microfinance in Indonesia. According to Bourdieu, a *field* is a space of competition with specific rules and lore, wherein social actors struggle and impose certain strategies to enhance their position in the *field*. Following this metaphor, this chapter presents the findings and discussions on how accountability and governance practices in BMT A have helped it in maintaining and improving its position in the *field* for a long time. In particular, this chapter highlights how the organisational *capital* and *habitus* of BMT A affected its accountability and governance practices.

This chapter proceeds as follows. Section 8.2 provides the background of *Pondok Pesantren*, and Section 8.3 discusses the history on how BMT A entered the *field* of Islamic microfinance. Understanding of both these aspects help in understanding of the organisational *habitus*, this will be discussed in section 8.4. Section 8.5 describes the *capital* of BMT A, while section 8.6 will go on to explain accountability and governance practices in BMT A. The development of accountability and governance practices in BMT A is discussed in Section 8.7, followed by the summary and conclusion in section 8.8. The structure of Chapter 8 is illustrated in Figure 8-1.

Figure 8-1 The structure of chapter 8



8.2. Background of BMT A and relation to Pondok Pesantren

Before discussing the history of the establishment of BMT A, the first part of this section presents an overview of *Pondok Pesantren* ‘S’ (PPS), whereby a group of teachers from the *pesantren* (a traditional and Islamic boarding school) established a financial institution based on Islamic teachings. Moreover, understanding daily life and activities within the PPS also helps in gaining an understanding on the construction of the organisational *habitus* of BMT A, because *habitus* embodies the social and historical background of institutions.

The term *pondok pesantren* comprises of two words: *pondok*, which is derived from the Arabic word *funduq* (lodging), and *pesantren*, an Indonesian term meaning a ’place‘ for *santri* (students) (Dhofier, 1980). Hence, *pondok pesantren* refers to a form of Islamic education system encompassing: *santri* (student), *kyai* (Islamic scholars/teachers), *pondok* (lodging), *masjid* (mosque) and *kitab kuning* (classical Islamic books) (Dhofier, 1980). *Pesantren* was considered to be the oldest and only form of formal education system found in villages in Javaprior to the twentieth century (Lukens-Bull, 1999). The distinctive feature of the *pondok pesantren* education system is the requirement for the *santri* to settle in *pondok* with other students under the supervision of the *kyai*, because *the kyai* were deemed to be role models of the authentic Islamic way of life. The aim of this education method is to ensure that the *santri* do not only learn religious texts but also practise Islamic moral and ethical values in their daily lives. Therefore, the *kyai-santri* relationship has created the robust bond of obedience, which extends beyond the *santri's* time in the *pesantren* (Lukens-Bull, 1999).

PPS is situated in a small village near the city of Pasuruan in the province of East Java. Although the distance from the nearest city is only 15 km, it is not easy to reach this village as public transport is limited. It is a 20-minute drive from the main road through a narrow village road with views of rows nof rice fields on either side. The population of this village is about 3,000 and the villagers are from two ethnic backgrounds, Maduranese and Javanese, and their main economic activity is farming (Monografi Desa/Village Monograph 2012).

The exact date of its establishment is debatable, with one document indicating that it was founded in 1745, and another indicating that it has existed since 1718 (Bakhri, 2011). At the beginning, there was no structured educational system, as the *santri* learned the *Quran* only from the *kyai*. The education focused on the *ma'hadiyah* (a non-formal system), whereby the *santri* were provided with additional skills in order to prepare them to be *khairu ummah* (the best of people), who will uphold *akhlakul karimah* (good character) in all their everyday activities.

As part of its development and to meet educational demands, one of the *kyai* established the *madrasah* (school as key to knowledge) in 1938 at an elementary level, which is referred in Arabic as *Madrasah Miftahul Ulum* (MMU) (Bakhri, 2011). Since then, the PPS education system gradually began to implement the *madrasiyah* (modernised traditional schooling system) covering three levels of education: *Ibtidaiyah* (primary, lasting six years), *Thanawiyah* (junior secondary, lasting three years) and *Aliyah* (senior secondary, lasting three years). PPS preserved the education system based on *salafiyah* (traditional), which emphasises the students' mastery of *diniyah* (theology), including aspects such as the interpretation of the

Quran, *hadith* (words and actions of the Prophet Muhammad) and *ilm hadith* (knowledge of hadith), *fiqh* (Islamic jurisprudence), Islamic history and the Arabic language (Bakhri, 2011). Besides managing their *pesantren*, PPS also oversaw other *madrasah* at the sub-district level, which comprises hundreds of institutions, as explained by the marketing manager:

> *"They adopted the PPS curriculum, which meant that they received mentoring, subsidies and guidance to aid in developing their education system. Teachers in these madrasah developed a teachers' network, which later provided significant support in initiating and developing BMT A" (SD03).*

The PPS educational system also requires the *santri* to conduct religious duties for one year after finishing junior secondary level. Every year, PPS sent about 1,000 *santri* to other *pesantren*,(which were spread across Java, Bali and the Kalimantan Islands) to teach. They were only allowed to continue their study at senior secondary level after completion of this teaching duty. Interestingly, PPS does not confer any certificate to its graduates, as it believes that the PPS alumnus obtains its certification from Allah. Nevertheless, according to the marketing manager:

> *"PPS is still the student's first choice of study institution in Java. Nearly 8,500 people from various regions attend the PPS and the majority is come from Madura Island" (SD01, SD03).*

The PPS academic year is based on the Islamic calendar; the holidays conform to the *Ramadan* and *Shawwal* month (the ninth and tenth month in the Islamic calendar, respectively). PPS also enforces a gender segregation policy and only accepts male *santri*, who are required to stay in *pondok* and are not allowed to visit their family, except under specific circumstances. They were allocated in 14 blocks of a building in one complex. Besides learning theology, they are also trained in upholding responsibility in their daily activities, such as cooking and cleaning for the group as well as ensuring that the members of the group follow the teaching-learning process and other activities. Hence, it is not surprising that they are very close to each other and live almost like a family, not only during their time in the *pesantren,* but also after they have completed their studies (SD03,). Their experience of studying and living in the PPS system for years obviously shaped their attitudes, behaviours, perceptions, actions and their way of thinking or, in other words, their *habitus*. The next section will outline the historical background of BMT A in entering the *field* of Islamic microfinance and establishing financial services based on Islamic teaching.

8.3. The history of BMT A in entering the *field* of Islamic microfinance

The embryo of BMT A's establishment can be traced back to 1961, when the chairman of PPS founded a cooperative to develop the *santri's* entrepreneurship skills, in order to subsidise their daily needs, such as buying groceries and stationary (SD02). The cooperative grew significantly but their activities were limited to serving only the *santri* and staff. However, during the period of 1995–1996, money lending activities were rampant in the village and many vendors around the PPS experienced financial difficulties due to the high interest rates charged by the moneylenders. The general manager of BMT A explained:

> *"Although they owed IDR 100,000, they received only IDR 90,000 and were required to pay instalments of IDR 5,000 every 24 days, making the total repayment to be IDR 120,000, which amounts to an interest rate of 33% per month" (SD01).*

A group of PPS teachers or *asatidz* felt uneasy with the situation faced by the vendors, and emphasised to the villagers during their *dakwah* (propagation) and *pengajian* (public sermon/recitation of the *Quran*) activities that *riba* (interest) is *haram* (prohibited), and as Muslims, they should refrain from paying interest to moneylenders who overburdened their financial situation. The borrowers' response was that they had no alternative due to the fact that there were no institutions or individuals willing to provide loans without interest. In fact, they challenged the *ustadz* (the singular of *asatidz*) by saying, "we will follow the advice if *ustadz* can help us to borrow money without interest" (SD06). In reality, despite being burdened, they were accustomed to the moneylenders' provision, as they had no other choice when it came to obtaining alternative sources of funding. No interest-based institutions were willing to provide loans for small entrepreneurs. Although a number of rural banks operated in some areas, they set a limit on the minimum loan given, being anything that was beyond the borrower's ability to repay. In short, the lack of financial services available to vendors was the main reason that caused the borrowers to be drawn into the *riba* system. The general manager further explained:

> *"In order to address this issue, as well as to impede the proliferation of riba, a group of asatidz [PPS teachers] started to hold musyawarah [discussions] to work out how to solve the problem. They realised that their dakwah [propagation] on riba prohibition as stated in the Quran "Allah has permitted trade and has forbidden interest" (The Quran. Al-Baqarah, 2:275), was not effective in a society that had become accustomed to riba" (SD01).*

Almost at the same time, specifically in 1996, there was a seminar on the socialisation of the concept of saving and lending based on *shari'ah* at the *Pondok Pesantren Genggong* in Probolinggo, about 50 km from PPS. The speakers were the chairman of PINBUK (*Pusat Inkubasi Bisnis Usaha Kecil* – Centre for Small Business Incubation) and a representative from the Indonesian Ministry of Cooperatives and Small Enterprise. A group of PPS teachers, who were concerned about *riba*, attended the seminar and upon their return they were determined to take action to fight *riba* activities (SD02). Five prominent *asatidz* (the plural of *ustadz*) pledged to take action to diminish the rampant *riba* activities by providing interest-free small loans to the poor villagers. According to the general manager:

> *"In order to realise this idea, they organised a fundraising event which was attended by 348 people from the PPS teachers' networks and community leaders. They succeeded in mobilising IDR 13.5 million*[12] *as the initial capital with which to start the project" (SD 01).*

How the *asatidz* started the micro-credit pilot project, administered the business and managed the development of BMT A, has influenced their *habitus* and *capital*. These will be discussed further in the next two sections.

8.4. The organisational *habitus* of BMT A

According to Bourdieu, *habitus* is a disposition rather than deterministic, and is both personally and socially constructed. Therefore, at the organisational level, *habitus* incorporates concepts of organisational culture (Goddard, 2004) and can be seen through perceptions, thoughts, behaviours and actions. As discussed in Chapter Five, the embodiment of the Islamic faith, which was inculcated during the *santri's* life in the PPS, has produced the *habitus* of BMT A. It is manifested in their perception of business as a medium for *dakwah*, their commitment and moral obligation to preserve the dignity of the PPS and their belief in the power of *doa* (prayer) in helping the poor refrain from disgraceful actions. The beliefs and perceptions that were formed during their time at PPS and developed to the present day have shaped the moral disposition, or the *habitus*, of BMT A. Details for each *habitus* will be explained in-depth in the next section.

8.4.1. Perception of business as a medium for *dakwah* (propagation)

As already discussed in the previous section, the idea to establish Islamic financial services was based on the spirit of eliminating the rampant *riba* that impinged

[12] *Equivalent to GBP 685, the exchange rate then being 1 GBP = IDR 19,70 (1st May 2015)*

vendors in the village in which the PPS is located. Calls to circumvent *riba* were ineffective and there was a need for real action to fight *riba* by exemplifying the practice of non-*riba*:

> *"We followed the Prophet (PBUH) in conducting dakwah [propagation] by going into market and demonstrating how trade should be conducted honestly and fairly. So, we went to the vendors in the market and offered them non-interest loans" (SD01).*

In their *dakwah* activities, they not only emphasised that *riba* is *haram* but more importantly, that they understood the reason for the prohibition. They explained how involvement in *riba* practice brings *mudharat* (disadvantage) rather than *manfaat* (benefit), as the high interest rate charged on the payment is immensely burdensome and that whatever potential profits they may generate would be cancelled out by the repayment of the loan and interest, which also means that they would lose the opportunity to keep any profits that they make. As a result, they would remain in perpetual poverty. Furthermore,

> *"…they [asatidz] also highlighted that it is impossible for impoverished people to fulfil two of the five pillars of Islam, the command to pay zakah and the obligation to go to hajj (pilgrim to Mecca). Therefore, the issue of dakwah to avoid riba is approached by touching on human duty in fulfilling obligations to Allah" (SD01).*

In mobilising the fund, *dakwah* is also considered as an effective way to attract people to deposit their money in the saving products of BMT A (SD05). They adopted the concept of brotherhood in Islam, which upholds mutual help among Muslims with the aim of narrowing the social and economic inequalities within society as stated in the *Quran*.[13] Islam encourages people to confer almsgiving for those who are in need and to the poor through *zakah*, as part of the act in purifying

[13] The Quran states, "The believers are but brothers, so make settlement between your brothers. And fear Allah that you may receive mercy" (The Quran. Al-Hodjoraat. 49:10). The Quran promotes the brotherhood's relationship to "cooperate in righteousness and piety, but do not cooperate in sin and aggression" (The Quran. Al-Maidah. 5:2)

the soul.[14] *Zakah* is obligatory almsgiving for all those who are able to do so, *viz* people who have acquired assets continually for more than one lunar year that are in excess of the *nisab* (a monetary-value threshold obligated to pay *zakah*). Although *zakah* is compulsory for those who are categorised as those who can afford it, Islam advocates all Muslims to do so invariably as part of charity. This market niche was developed through the introduction of a collective fulfilment of *zakah*:

> *"If we could not share [what we have] individually with others, we still have the opportunity to share it collectively" (SD05).*

The advantage for depositors of saving money with BMT A is seeking *hasanah* (reward from Allah), since 2.5% of the profit sharing from their deposits will be deducted for *zakah* and distributed for use in social activities. By doing this, the source of funds for BMT A has been collectively facilitated by their depositors in fulfilling one of the five pillars of Islam, which might otherwise be impossible for small personal depositors to fulfil.

The spirit of *dakwah* is manifested through all activities within BMT A. During the interviews, the participants emphasise that their business activities are based on *sharia* (Islamic law), which is not surprising since Islamic values have been embodied in their behaviour, as it has been taught for years during their study in the PPS system. They were also taught that *dakwah* is every Muslim's obligation.[15]Hence, they were equipped with the skills and knowledge to become *da'i* (Muslim preachers) and their education system required them to have a mastery

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[14] The basic principle of *zakah,* as stated in the Quran, is to purify the soul: "Take [O, Muhammad], from their wealth a charity by which you purify them and cause them increase, in invoke [Allah's blessing] upon them" (The Quran. At-Taubah. 9: 103).

[15] As the *Quran* states: "Say, this is my way; I invite to Allah with insight, I and those who follow me..." (The Quran. Yusuf. 12:108), while the Prophet (PBUH) suggests, "Spread the word [knowledge from me] despite only one verse" (Bukhari).

of a certain level of *fiqh*, including *muamalah* (commercial transactions). Their knowledge was obvious as the interviewees frequently quoted chapters and verses of the *Quran* and *Hadith* in fluent Arabic, and able to interprete the meaning of the quotations in Indonesian language, as the researcher does not understand the Arabic language. They were also able to relate these teachings back to contemporary issues by demonstrating the rationale underpinning their activities.

Dakwah is also implicitly included during the *uqud* (contractual agreement) process between customers and BMT A. Prior to signing the contract, the debtors were probed on their current business activities and how they would utilise the fund. They were also given *ceramah* (advice) to remind them of their obligations to repay the loan, as the fund belongs to the *ummah* (society), and that they would therefore be accountable to them. Defaulting on loan repayments is deemed as a betrayal of the *ummah's* trust. Once the contract is signed, both parties make a supplication to Allah by reciting Al-Fatihah[16], that the fund would bring *barakah* (Allah's blessing) to their business. When there is a default on the repayment, the staff dealing with the loan repayment would remind the debtor of their moral obligations toward the *ummah* as commanded by Allah, rather than to them as credit provider. They claimed that by adopting this approach in their operation, the level of loan defaults was almost 0%. In other words, the 'soft' approach of reminding debtors of their obligation to *ummah* and Allah is deemed more powerful than the 'hard' approach of emphasizing on their responsibility to the organisation. Furthermore, in Islam, the debtor should be granted time to repay their debt if they are struggling, and it is better to dismiss it as charity, wherever possible (Haniffa, Hudaib & Mirza, 2005).

[16] This chapter in the Quran is called "The opening", and is the fourth and most important chapter in the Quran. The seven verses in this chapter are a prayer for God's guidance, stressing His Lordship and His mercy. It is recited at least 17 times a day at the start of each unit of prayer (*rakaah*).

They also view the business they administer as the manifestation of *amanah* (trustworthiness). As a consequence, the interests of the *ummah* take priority over the interests of individuals or particular groups. They claimed that one of the key success factors for the incredible development and sustainability of their operations is attributed to their selflessness and altruism.

> *"Our mission is to conduct business with a dakwah element to it, as the main goal is achieving the state of maslahah mursalah lil ummah or unrestricted benefits and welfare of the ummah" (SD04).*

In conducting their business, they strive to follow the admirable characters exemplified by the Prophet Muhammad (PBUH): *siddiq*, *amanah*, *tabligh* and *fathonah*.[17] From the beginning of the establishment of BMT A, the founders realised that none of them had any experience or educational background in financial services, but they strongly believed that any business built on the foundation of *siddiq* and *amanah* will ensure success.

> *"For us, siddiq [truthfulness] and amanah [trustworthy] are the two attributes that is fundamental for our employees to possess, while fathonah [intellect]and tabligh [advocacy] can be achieved later. Furthermore, character building based on siddiq and amanah is not an easy task, and must be taught persistently, and developed as part of social habits and norms. Most of the major causes of failure in the financial services are due to the administrators not having these characteristics" (SD06).*

Moreover, these characteristics were claimed to also indirectly enhance mutual respect and eliminate distrust not only between managers and employees, but also with their customers. As a result,

[17] *Siddiq* (truthfulness) was one of the key success factors for the Prophet's business, as it is based on the fundamental principle of mutual cooperation and mutual benefit among the parties involved. *Amanah* refers to one's sense of responsibility in completing tasks and duties to the best of one's ability, while *tabligh* (advocacy) is about the dissemination of information with full transparency and sincerity, and *fathanah* (intellect) refers to one's ability to solve problems through mastering concepts and broadening knowledge.

"The relationship between employees and staff resembles the obedience of students toward their teachers. This had shaped harmony in the organisation" (SD06).

8.4.2. Loyalty towards PPS

The majority of employees of BMT A are PPS alumni. They have studied, lived and been nurtured in the same place for many years. They have been taught the same information and inherited the same rituals, practices and customs that have been passed from one generation to the next. They have grown and matured in the PPS environment and therefore perceive PPS not only as a second home, but also as part of their identity and a way of life that should be upheld at all times. Moreover, they also made a commitment to *mewakafkan diri* (dedicate themselves) to the virtues of PPS.

"*We never ask what PPS gives us, but we always ask what we have done for PPS" (SD01).*

"*Anytime PPS call us, we make ourselves available and willing to leave our other commitments" (SD06).*

Since BMT A came into existence from *pesantren*, the interests of PPS take top priority. They also believe that BMT A has developed to become a significant institution due to entrenched societal trust in PPS. Furthermore, BMT A has also grown significantly due to *syafaat* (blessing from those people who are considered close to Allah, whose supplication will always be granted) from the *kyai* of PPS.

Therefore, the activities of BMT A are devoted to maintaining the reputation of PPS. As previously discussed, PPS's founders decision to start the operations of BMT A in a village that was distant from PPS was mainly because they did not want to risk the project failing and consequently undermining PPS's reputation, which had been built over two centuries. When BMT A managed to demonstrate business success, it provided perpetual support to PPS by contributing part of its profit for educational development and supporting PPS's *dakwah* activities. The allocated funds were then used to improve the teaching-learning facilities as well as for maintaining or constructing new buildings, if needed. As such, the *santri*'s parents were not burdened with the obligation to pay the full school fees and living costs and they voluntarily contribute as much as they could afford. In this way, the *santri* are expected to have a greater sense of responsibility to continue the mission of PPS in spreading Islam through *dakwah*.

Moreover, in order to maintain *silaturahim* (good relationship) between *kyai* and *santri* who are spread across various islands, BMT A also sponsors religious trips to several regions (SD01). The alumni in certain areas are encouraged to establish a board of representatives, with the aim of improving coordination among them and continuing communication with PPS. The representative is required to rent a place in the mosque to hold *pengajian* (communal *Quran*ic studies), which is attended by the *kyai* of PPS, fully funded by BMT A. The *kyai* and personnel of BMT A were invited to remind themselves of the *kitab kuning* (traditional Islamic scripture). Since the alumni live in different locations, they may encounter different challenges that might contrast with their way of life in PPS. Hence, *pengajian* is considered to be an effective way to remind the alumni to firmly uphold Islamic teachings in their everyday lives.[18]

During the *pengajian*, BMT A will introduce its business plans and encourage the alumni to develop mechanisms in the provision of financial services in their region.

[18] As stated in the *Quran*: "By time. Indeed, mankind is in loss, except for those who believed and done righteous deeds and advised each other to truth and advised each other to patience" (The Quran. At-Takaasor. 103:1-3).

Their mission to *berkhidmat* (to serve) society by assisting and releasing them from the grip of the moneylenders and involving in *riba* practices, through offering of interest-free loans, were seen as vital.. BMT A also provided support to the administrators by providing them with initial capital, a computer, and basic training. At the beginning, the alumni felt hesitant in performing this assignment as they were concerned about the possibility of failure if the business was administered by themselves, as they had never been taught economics or financial management during their study in PPS. Moreover, building societal trust towards the Islamic financial institutions was problematic, since a number of BMTs in the region collapsed, and distrust of such institutions was still strong.

> "*However, BMT A's management did not give up easily, and kept on trying to convince the alumni to establish BMT in their area as part of their dakwah to eliminate riba. Their obedience and trust in the kyai resulted in the establishment of various branches of BMT A (SD08).*

8.4.3. The organisational customs and attributes

BMT A's three-floor building is strategically located on the main street of the central village, opposite the traditional market and surrounded by a shopping area – the centre of villagers' daily activities. The building is green in colour, which is synonymous with *Nahdlatul Ulama,* and is associated by Muslims with Islam. The ground floor of this building is utilised as a branch office that provides financial services to BMT A's clients, the first floor is used as a management office, and the second floor as a meeting room.

Two distinctive features were observed during the researcher's time at BMT A's headquarters: all the employees are male, and their dress code consists of a *sarong* (wrapped cloth, usually with a plaid design), a white *peci* (head cap) and leather *sandals*, rather than modern attire. They said that their background as *pesantren* affects every aspect of their everyday lives, including the way they dress.

> "*This is our identity; we are proud to be called kaum sarungan (the sarong-clad group), and we believe that our traditions will not be imitated by other financial-services providers" (SD05).*

Moreover, the chairman of the board, added:

> *"…the sarong is associated with Muslim identity, so wearing a sarong will remind us to be good Muslims and, in particular, refrain from engaging in unethical business practices, such as being greedy or ruthless" (SD06).*

As for the restrictions placed on female employees, the general manager of BMT A argues that:

> *"We uphold the Islamic view that prohibits free intermingling between males and females. This institution was initiated by male pesantren, who established a policy to hire its own graduates – who are all male. We are committed to preserving the authenticity of PPS" (SD01)*

BMT A's office hours are from 07:00 to 14:00, Saturday to Thursday. In the evening and outside office hours, the majority of the employees will switch profession and become *ustadz* (religious teachers) at PPS or some other Islamic education institution. During their study in *pesantren*, PPS's employees have been taught that their main duty as a Muslim is to make *dakwah* and teach the *Quran,* as mentioned by the head of the branch office:

> *"My position in BMT is a sideline job that is mundane and only temporary. I need to balance my life with spiritual activities by teaching the Quran to the children in my village" (SD02).*

The office closes on Fridays to coincide with the PPS holiday that dismisses students in order to enable them to go to mosque to perform *salat al jumu'ah* (Friday prayers).[19] Hence, BMT A decided to close their offices on Fridays and believes that this will bring them more *rizq* (sustenance),

> *"…because Friday is considered to be the day for Muslims to gather, just as was the case during the Prophet Muhammad's time (PBUH) (SD02).*

Another of the *pesantren's* traditions that have been imbued in BMT A's organisational culture is the bond and long-term relationship between the *asatidz* and *santri*. Most of the company's employees, including the management team, have known each other since they were in the same *pesantren*. The mid- and top-level management positions are held by *asatidz,* who have at one time or another taught the majority of the employees. Hence, employees' attitude towards managers and the management team is similar to the respect held by *santri* toward their *asatidz.*

> *"The unquestioning obedience of santri to asatidz in the pesantren has its root in the kitab kuning (Islamic text) teaching, particularly the section on Ta'lim al Muta'allim tariq al-Ta'allum, which literally means: instruction of the student – the method of learning" (SD06).*

This part of the *kitab* teaches students learning etiquettes i.e. to fully respect their teachers by not sitting on the teacher's seat, not walking in front of their teachers and not speaking to teachers without first being given permission to do so. The loyalty of the employees to their *asatidz* is expressed by kissing the teachers' hand while greeting with *assalamu alaykum* (peace be upon you). They believe that the act of kissing hands and respecting the *ustadz* will bring them *barakah* (blessings from Allah). Moreover, the employees use *karma,* the most polite form of language, which is derived from a mixed of Maduranese and Javanese languages, when they converse with the *asatidz*.

[19] This was in conforming to the Quran which states: "...when the *adhan* [Islamic call for worship] is called for the prayer on the day of Jumu'ah (Friday), then proceed to the remembrance of Allah and leave the trade. That is better for you, if you only knew" (The Quran. Al-Djomo'ah. 62:9).

Different forms of both languages are adopted when conversing between one another depending on the social class and context; *ngoko* is used for informal conversation between close family and friends of a similar age; *madya* is used when conversing formally or informally when speaking with those of unknown social status, while *karma* is polite and formal, used only when speaking to people of a higher status. Maduranese is the workplace language, using *ngoko* when speaking with colleagues and switching to *madya* when servicing customers. *Bahasa Indonesia* is only used to speak with strangers or visitors from outside the village.

8.4.4. Ritual and religious practices in the workplace

BMT A's building is equipped with a *musalla* (Islamic prayer room)[20] on the first floor, complete with modest *wudhu* (ablution) facilities on the ground floor. Following their customs in the *pesantren*, the management staff and employees always perform *salat jama'a* (congregational prayer) for *zuhr* (midday prayer) as praying in congregation brings more spiritual and social benefits:

> *" as stated in the Hadith: "The prayer of one who hears the adhan but does not participate in the congregational prayer of Muslims for no (justifiable) reason at all is worthless. Another Hadith also mentioned that a single prayer in congregation is better than forty years of prayer at home" (SD02).*

During prayer time, all services are stopped temporarily for about 30 minutes to enable the staff to have a break for lunch as well as fulfil prayer obligation. The *adhan* (call for prayer) machine is automatically switched on and can be heard throughout the whole building when it is prayer time. Any customers that have not yet been served will be informed that service will be paused for prayer, and they can

[20] *Musalla* is different from the mosque, as it is much smaller and intended to be used as a prayer room, mainly by employees to conduct prayers when the time for prayer comes.

either wait until the staff finish their prayer or return back later. Most customers are aware of this and usually avoid coming around prayer time.

Mimicking what they have learnt from the *pesantren*, staff will say their prayer before starting any activities as they believe that this will provide them with spiritual power and protection from misconduct and sin. About 15 minutes prior to opening time, staff who arrived early will gather in the waiting room and recite *surah Al-Fatihah*[21] together. They will then continue to make *Tawassul*[22] (intercession) to PPS's *ulama* as they are being perceived to be closer to Allah and because they strive to further the cause of Allah, their prayers will be answered. Although this practice is considered as *shirk* (polytheism, seeking the help of other than Allah), the chairman of the board defended the practice:

> *"…we consider tawassul to be lawful because the origin of this practice can be seen in the Holy Quran "Oh you, who have believed, fear Allah and seek the means [of closeness] to Him and strive in His cause that you may succeed" (The Quran. Al-Maidah.5:35). (SD06).*

At the end of each day, the staff comes together for *Istighfar*[23] (seeking forgiveness) and *Salawaat*[24] (salutation to the Prophet of Muhammad) before they return home. Staff believe that they may have unintentionally acted wrongfully while performing

[21] *Al-Fatihah* literally means 'the opening' and is the first chapter in the Quran. It is considered as the greatest *surah* and *umm Al-Quran* (mother of the Quran).
[22] *Tawassul* is derived from the Arabic *wasiilah* (intercession); it refers to religious practices in which Muslims pray to Allah by seeking intermediaries such as the Prophet or *Imam* (Islamic leaders).
[23] *Istighfar* involves saying the Arabic word *astaghfirullah*, which means "I seek Allah's forgiveness". The benefit of making *istighfar* is that it helps to enhance productivity, provide relief and happiness, as well as open the door for mercy, knowledge and sustenance. *Istighfar* also helps people refrain from various forms of sin.
[24] *Salawaat* is a salutation to the Prophet (PBUH) by sending blessings for him and his family. This deed has been encouraged in the Quran: "Indeed, Allah confers blessing upon the Prophet, and His angels [ask Him to do so]. O you who have believed, ask [Allah to confer] blessing upon him and ask [Allah to grant him] peace" (The Quran. Al-Ahzaab. 33:56). Islam teaches that the Prophet (PBUH) is the best among the children of Adam, and Allah's blessing could not reach humankind unless through belief in His Messenger.

their duties during the working day. Therefore, by making *istighfar*, they get relief from any feelings anxiety or sadness, as explained by the general manager:

> *"The Quran commands Muslims always to make istifghar: "Seek forgiveness of your Lord and repent to Him, [and] He will let you enjoy a good provision for a specified term and give every doer of favour his favour. But if you turn away, then indeed, I fear you the punishment of a Great Day (The Quran. Hud. 11:3)" (SD01).*

Similarly, *salawat* is perceived as the most valuable deed Another *pesantren's* traditions is to carry out *istighosah*[25] (seeking relief), and the staff and management team of BMT A also do this once every month at the graveyard of PPS's forbearer (SD02). *Istighosah*[26] is a collective prayer that involves mass participants, usually hundreds or thousands of people, and as such, it is held in an open field or stadium, led by the most prominent *ustadz*. For the staff and management team of BMT A, this practice is believed to be a way of drawing them nearer to each other and helping to protect them from any difficulties that they may face in the future, as explained by the head of the branch office:

> *"Allah said, "[remember] when you asked help of your Lord, and He answered you, Indeed, I will reinforce you with a thousand from the angels, following one another" (The Quran. Al-An'faal. 8:9)" (SD02).*

From the discussion in this section, it is clear that the *habitus* of BMT A has largely been shaped by the experience the employees had during their time as students at PPS. The next section discusses the identification of *capital* possessed by BMT A and how the *capital* together with *habitus*, affect the company's accountability and governance practices.

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[25] The term *istighosah* is similar to the Arabic word *thalabul ghouts*, which means seeking requesting relief.

[26] They pray to Allah by reciting *dhikr* (remembrance of Allah's names), followed by recitation of surah Al-Fatihah once and Ya Sin thirty-six times, ending with *doa*.

8.5. The *capital* of BMT A

Within a *field*, social actors compete to accumulate different types of *capital* and exploit them in maintaining or improving their relative position in the *field* (Swartz, 1997), and at the same time, *capital* and *habitus* together produce a certain practice. According to Bourdieu, *capital* is generalised resources involving different types of capital: monetary or non-monetary, and tangible or intangible (Bourdieu, 1986). The identification of capital possessed and accumulated by BMT A is as follows.

8.5.1. Economic capital

The *economic capital* of BMT A refers to a form of capital that can immediately and directly be converted into money. This comprises the different sources of funding and various types of assets, as presented in the financial reports. The *economic capital* of BMT A has grown significantly during the last 15 years. When it was established in 1997, the initial capital was only IDR 13.5 million[27] but in 2012, BMT A was recognised by the Ministry of Cooperative and Small Enterprise as the largest Islamic cooperative in Indonesia, with assets reaching more than IDR 662 billion (Financial Report, 2012).

According to the marketing manager (SD 03), BMT A's sources of funds can be classified into internal and external. The internal source, savings, refers to the contributions made by members, and comprises compulsory savings, voluntary savings and special savings. Compulsory savings are paid only once, when a member registers, while voluntary savings are paid annually, and special savings are paid individually, with amounts varying among members. The compulsory savings are returned if a member withdraws their membership, while the voluntary and special

[27] About GBP 685, exchange rate then being 1 GBP = IDR 19,702, (1st May 2015)

savings can be withdrawn every year. The external source, on the other hand, comprises three types: funding from society, grants from the government and loans from an Islamic bank. In general, the structure of funding within BMT A:

> *" is dominated by saving with about 72% from society, 16% from internal sources, and only 12% loan from the Islamic bank (SD 03).*
>
> *"In reality, our fund can cover the need for liquidity. We requested a loan from the bank as a reserve fund and we almost never used it" (SD01).*

In terms of the number of branches, by mid-2012, BMT A had 81 branches spread across nine provinces throughout Indonesia (SD03). Each of the operational office's branches has land and a building, as well as vehicles and inventories. BMT A has also built a three-storey building as its head office and the training centre (SD01).

8.5.2. Cultural capital

According to Bourdieu, *cultural capital* can emerge through traditional social class positions within society, better education, communication skills or language proficiency (Bourdieu, 1991). Therefore, the *cultural capital* of BMT A corresponds to educational background, working experiences, knowledge, skills and expertise of the employees, including the management team. In terms of educational background, as discussed in the previous section, all staff and the majority of the management team are graduates of PPS who have mastery of Islamic theology but none of the BMT A's management team had any knowledge or skills in business, accounting, economics or management when BMT A was first established (SD11). Nevertheless, the staff and management continued to enhance their *cultural capital* through their own experiences and undertook various trainings in business and Islamic financial services at a number of institutions. Based on its success story, BMT A became a reference for studying IMFIs in Indonesia. A number of students have carried out research on or conducted apprenticeships in BMT A (SD01). Moreover, a number of BMT managers were invited as trainers to train staff in other IIMFIs (SD03). In fact, in 2012,

> *".. we established a training centre to provide internal and external education and training for both our own new employees and for employees of other institutions (SD01).*

PPS's *kyai* and *ustadz* are also considered to be a powerful source of *cultural capital* of BMT A. They played significant roles in supporting BMT A to accumulate *economic and social capital* through *dakwah*. This is because, in Javanese society, *kyai* and *ustadz* from the *pesantren* tradition are recognised as religious and charismatic leaders. They managed to persuade people to stay away from riba by depositing their money in BMT A and receive a personal guarantee that their funds will be managed in accordance with *shari'ah* without overlooking the economic benefits (SD01).

8.5.3. Social capital

Social capital relates to the relationship of the institution with other parties. In this sense, the *social capital* of BMT A is related to the establishment of networks with members, clients or customers, Islamic banks, governments, the association of IIMFIs, and other IIMFIs. From its establishment, the PPS alumni who serve as teachers near the village wherein PPS is located became the main supporters and founders of BMT A as they donated money for BMT A's initial capital. In mobilising the funds, BMT A invited PPS's alumni to become members by establishing membership contributions. By mid-2012, the number of members reached 1,993 (SD05). Alumni who returned to their home across various regions in

Java, Madura, Bali and Kalimantan were encouraged to establish BMT A branches. The clients or users are also an important element of the *social capital*, and as discussed in the section covering *economic capital*, the proportion of savings from this group is dominant in the funding structure. Having 81 branches in 9 provinces, BMT A claimed to have served more than 10,000 clients or users (SD01).

BMT A established relationships with Islamic banks with the following aims. Firstly, any excess funds deposited in the Islamic banks can be used as collateral if BMT A requires additional funds for its liquidity. Secondly, it benefitted from the excellent service training provided by the Islamic banks. Since BMT A is, in the eyes of the law, a cooperative, it needs to abide to the Cooperative Act, which included the obligation to submit annual financial reports to the Dinas Koperasi Kabupaten (the Cooperative Office at the district level). Moreover, in the BMT A's annual general assembly the staff from the Department of Cooperatives was invited to legitimise BMT's accountability to its members and society. BMT A is also a member of the IIMFI's various associations such as INKOPSYAH and ABSINDO but is not as actively involved in their activities:

> *"The aim of being a member of these associations was to share experience and maintain the relationship with other IIMFIs, as well as to get current updates about the regulations and issues in this sector" (SD01).*

8.5.4. Symbolic capital

Symbolic capital develops through respect, prestige and reputation. Therefore, *symbolic capital* denotes recognition of the organisation's achievements by external parties. At the beginning of its operations, the reputation of PPS was the *symbolic capital* that helped BMT A to gain trust from society (SD01). The clients and users in general associated the existence of BMT A with PPS. They wholeheartedly trusted the PPS' *kyai* and *ustadz* when it came to saving with BMT A. Throughout its development, BMT A's good performance as a financial service provider, gradually earned societal trust as indicated by the increasing number of members, clients and users. Moreover, it received a number of awards from various institutions:

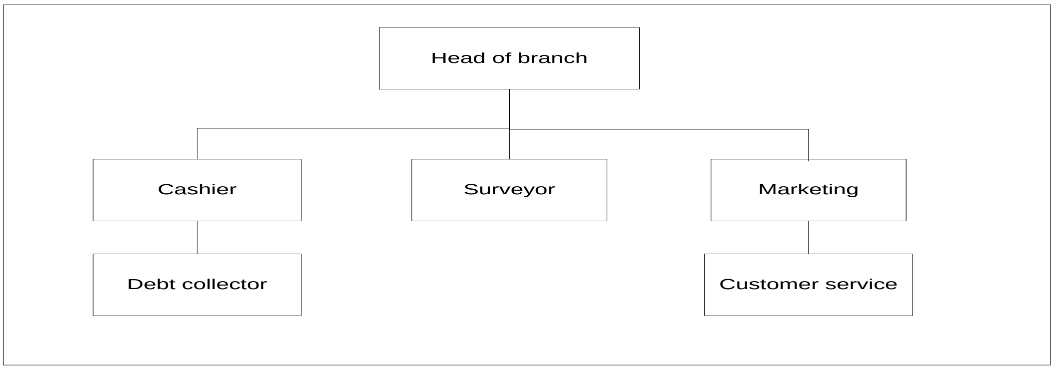
> *"The most prestigious awards were the Most Loyal Customer 2010 award from the Bank Nasional Indonesia (BNI) Syariah, the third top 100 largest cooperatives in Indonesia, according to the Ministry of Cooperatives and Small Enterprise in 2012, and, more recently, the award of Best Islamic Microfinance Institution in 2014, from Karim Consulting Indonesia (SD06).*

The discussion of the capital possessed and accumulated by BMT A demonstrates that the volume and variety of capital was not static, but was instead constantly developing along with the growth of the organisation. The next section discusses the accountability and governance practices of BMT A, which developed alongside the organisation's growth and influenced by the accumulation of *capital*.

8.6. Accountability and governance practices within BMT A

The identification of accountability and governance practices involves various activities. As discussed in the Chapter Two, accountability focuses on the day-to-day operations and processes related to receipt and distribution of loans, record keeping of transactions, and preparation of financial reports. Therefore, accountability in this study focuses on the activities carried out by BMT A's branches in providing financial services related to funding and lending activities. The organisation's branch structure is illustrated in Figure 8-2.

Figure 8-2 BMT A's branch structure



Source: BMT A

In attempting to standardise the financial services provided by the branches, BMT A has prepared a standard operating procedure (SOP) for saving and lending activities, and provided basic training on products and services for new staff in its various branches. The branches were equipped with the software to record transactions and produce a number of reports but it was not yet connected to the system at the head office as it required a great amount of investment to build online services between head office and its branches (SD09).

> *"Each of the branches can produce their own financial reports, which we asked to be sent to head office every month. We consolidated the financial reports of all branches and produced consolidated monthly financial reports" (SD09).*

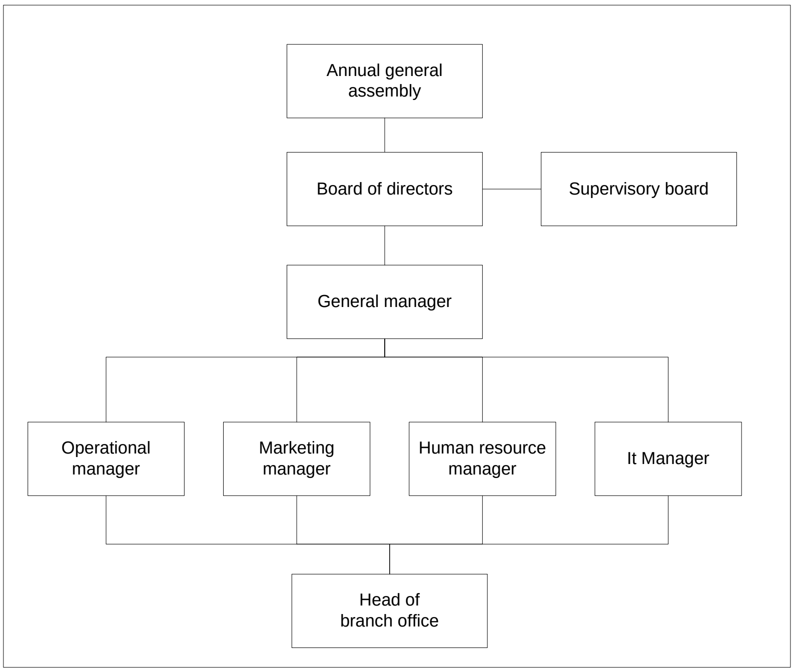
Furthermore, governance practices encompass both conformance and performance aspects, with the former relating to the adherence to laws and regulations, including *shari'ah*, while the latter focuses on strategies, policies and organisational structure. Therefore, the discussion on governance in this study concerns the activities conducted by the management team and the board. This includes a number of activities, such as:

- Establishing a strategic plan and programs for organisational development and achievement of the organisation's mission and vision;

- Setting the organisational structure and job descriptions;
- Setting the delegation of authority from the head office to the branches;
- Recruiting staff members, both at management and branch level;
- Establishing policies for salary or net-income distribution;
- Preparing budgets and monitoring the achievement of or deviance from budgets;
- Supervising and evaluating branch performance;
- Ensuring *shari'ah* governance;
- Establishing cooperation with external parties (the government, the Islamic banks, the IIMFIs association, other IIMFIs and other institutions) based on mutual benefits;
- Discharging accountability to members through organising the AGM;

The organisational structure of BMT A is illustrated in Figure 8-3.

Figure 8-3 BMT A's organisational structure



Source: BMT A

According to Bourdieu, *practice* constitutes relational thinking between *capital* and *habitus* within the *field* (Bourdieu, 1984). The growth and changes in *capital* together with the *habitus*, influences the changes in practice. How this occurs will be discussed in the next section.

8.7. The development of accountability and governance practices: *capital, habitus and field*

Since its establishment in 1997, BMT A has experienced significant growth. Its *economic capital* has increased substantially, and many branches have been set up in various places throughout Indonesia. The growth of their *economic capital* has been followed by the growth of *cultural, social and symbolic capital*. As a result, BMT A succeeded in managing their position in the *field* of Islamic microfinance. Therefore, this section focuses on how BMT A developed over the years from being a small institution in a remote village to becoming one of the biggest IMFIs in Indonesia. This study argues that the accountability and governance practice adopted by BMT A is the key factor in supporting the sustainability of its operation in the long term.

Therefore, this section will examine the accountability and governance practices that were developed within BMT A that followed the growth of its capital. The evolution of accountability and governance practices of BMT A can be classified into three phases: the pilot project for micro-lending, formalised organisation, and products and services expansion. Following Bourdieu's suggestion that *habitus, capital, field* and *practice* should be discussed in a relational way, this section will explain *capital, habitus and practice* during every phase. Moreover, the related issues and changes within the *field* of Islamic microfinance that has impacted BMT A's accountability and governance practices will also be explained. The following sections will discuss *capital, habitus* and *accountability practice* in each phase.

8.7.1. Phase 1 : Developing the micro-loan pilot project

Newly established organisations often have limited capital and resources, and have to rely on their creativity and innovativeness in offering services and products. Hence, formal managerial activities are relatively low, and the organisation is instead heavily reliant on individual and entrepreneurial spirit. As described earlier, BMT A entered the *field* of Islamic microfinance mainly due to the founder's concerns on the substantial number of vendors in the local village who were locked into high-interest loans due to lack of other funding options. Commercial banks set a minimum loan amount and required collateral, and *Bank Perkreditan Rakyat* (rural credit banks), which were able to provide small loans existed only in urban areas. Therefore, most villagers relied on ruthless moneylenders. The PPS *ustadz* felt they had a moral responsibility to stop the vendors from reverting to borrowing money from moneylenders. They asked for an endowment of IDR 2 million from PPS to pay off the vendors' loans but this effort was ineffective because the number of those in needs and their combined debt was much greater than the funds available.

The idea to provide an interest-free financial service was realised after a lengthy process. Supported by the PPS teachers' networks, the founders succeeded in collecting the donations that amounted to about 13.5 million.

> *"We were determined to realise this idea even if the funds we had were limited. Allah heard our prayers. We never expected to be able to mobilise such a considerable amount of money. This showed that we shared the same goal of diminishing riba. This strengthened our volition to provide interest-free financing to help poor people" (SD 06).*

Although they managed to raise the funds, they struggled to bring their idea to fruition, as they failed to devise plan outlining how to go about providing such loans based on *shari'ah*. Hence, they sought assistance from the Bank Muamalat Indonesia in Jakarta and consulted *Dinas Koperasi Kabupaten* (the Cooperative Office at the Municipal level) about the possibility of establishing a cooperative-based *shari'ah*. Unfortunately, during 1996, the concept of *shari'ah* business was relatively unknown and Act No. 25/1992, concerning cooperatives, had not provided a framework for *shari'ah* cooperatives. Following suggestions from the *Dinas Koperasi*, the founders of BMT A established a cooperative by simply registering the organisation for the sake of obtaining legal formality.

Another challenge in materialising the idea of providing interest-free loans was in convincing another group of PPS *ustadz* who questioned the capability of their fellow *ustadz* to administer the project, as none of them had any experience or background in business or banking and they feared that if the project failed, it would damage the good reputation that had been enjoyed by PPS for more than 200 years. However, the founders were determined to take action to inhibit the spread of *riba* because,

> *"..as ustadz, they felt they had a moral obligation to fight riba, as they strongly believed in the hadith from Ibn Abbas, wherein the Prophet (PBUH) mentioned that, "if adultery and usury has been proliferated, then they really have justified the wrath of God against themselves" (SD06,).*

Both parties held several *musyawarah* (discussions) and they managed to reach a compromise on the conditions that thepilot project for the lending program does not operate in the village in which the PPS operated and the founders not utilising the reputation or name of PPS in their activities. These precautions were undertaken to preserve the reputation of PPS, in case the program fails. Following the *mufakat* (agreement made during *musyawarah*), the founders sought the best location for running this program: it has to be within 15–20 minutes by motorcycle ride, so that they could continue to fulfil their principal responsibility as PPS teachers, while also being able to closely oversee the operation. Finally, they decided to run the program in the next village, which was located 10km from PPS. The program was launched to coincide with the Prophet's birthday on 12 *Rabi'l Awwal* 1418 H (the third of month in the Islamic calendar), or 17 July 1997. This was marked by holding a *selamatan*, a communal feast in Javanese tradition to celebrate any significant events such as birth, marriage, or any important events aimed at evading negative spirits, to achieve a peaceful state, in the office.

> *"Underpinned by sincere niat [intention] to help people and diminish riba, we started with the utterance of Bismillahirrahmanirrahim (In the name of Allah, the Entirely Merciful, and the Especially Merciful). We did not know how the program would be received, but we were determined to find out" (SD01, SD06).*

They learnt *fiqh* on *muamalah* (Islamic law or jurisprudence on commercial transaction) and learned the rules for business and the lending and borrowing contracts. However, they had no idea about how to implement such principles in real business.

When BMT A was established, there was a massive effort within the *field* of Islamic microfinance to bolster the growth of IIMFIs throughout Indonesia, which was initiated by PINBUK. It encouraged people to establish their own IMFIs and assisted them by providing training sessions in areas such as fundraising, administering loans, and, bookkeeping. Because BMT A is in a relatively remote area, the founders did not know about the training session held by the PINBUK (SD01) and hence they administered the micro-loan project based on their own creativity with their *niat* (intention) being solely to help people get out of *riba* transactions. The founders of BMT A ran the pilot project with limited *economic capital*. They used the initial capital to pay rent, salaries and the revolving loan. They rented a small shop (three-by-five metres) near the village's market to use as the operational office; there were only a few chairs and a table and there was no safe deposit box, so the staff had to bring the money back to their homes at the end of each day. They had relatively no *cultural capital* or experience in running this kind of business. There was no formal procedure for disbursing the loan, except setting the maximum threshold for each borrower. There was also no provision or criteria set up for the borrowers. They were required to pay the loan in instalments by the same amount they borrowed, without any additional fees or charges. However, BMT A placed a box for *infaq* (donations) if the borrowers were willing to contribute. Borrowers were allowed to borrow again only when they had paid off their loan in full.

To administer the program, two of PPS's alumni were hired but the job description was unclear except to adhere to the *kyai's* requests:

> *"We appointed former students who were deemed to be amanah and siddiq (truthful), regardless of their competence, as we believe this can be learnt later" (SD06).*

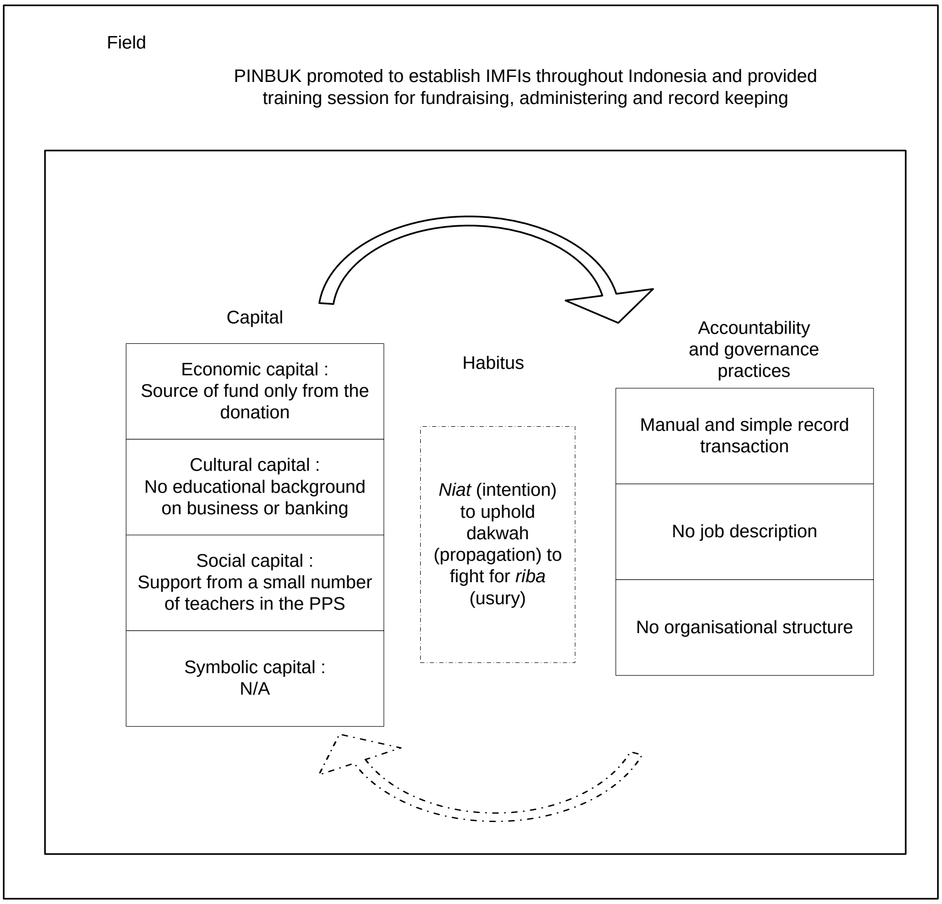
They undertook all tasks: looking for potential users, distributing the loans, receiving payments, recording the disbursement of loans, collecting repayments and keeping track of the fund. They learnt along with the founders how to prepare a modest recording system to record loans and payments by creating a table with three columns in a book; one for recording the amount of money they had disbursed, another for recording how much had been returned and the last column to record information about those borrowers who had not yet made repayments. They presented the records regularly to the founders and sought solutions from the founders whenever they faced problems. So, the focus of the accountability practices then was only related to financial matters conducted in an informal way between the employees and the founders.

The concept of governance did not exist. The relationship between the staff and founders was the same as the *santri-ustadz* (student-teacher) relationship seen in the PPS. The founders regularly reminded the staff that what they were doing was part of *jihad* (the fight) against *riba*. Since the concept of *shari'ah* in business was less well understood by borrowers, they failed to understand the difference between BMT A's financing program and the moneylenders' practice and the staff inability to clarify the benefits made it difficult to convince people to utilise the interest-free loans. Nevertheless, the founders and the staff continued their *istiqamah* (persistence) in carrying out this program and proofing that an interest-free loan can work in society.

The program ran well during its first two years, and BMT A claimed that were no loan defaults, all the funds were repaid and the loan's turnover was high. The program managed to slowly gain societal trust and the number of borrowers increased considerably. Due to the limited fund, they were only able to serve about 30-50 people on average but the demand for the loans continued to rise. Since the activities of BMT A increased significantly, the founders felt that they need to intensively oversee them in an attempt to preserve their vision of alleviating *riba*. After obtaining blessings from the PPS's *kyai*, BMT A's head office was relocated to the village in which PPS was located and plans for the development of BMT A were given more serious attention.

In short, when the founders established the micro-loans pilot project, their *economic capital* was limited and came from donations that amounted to only 13.5 million from a small group of teachers within the PPS's education network. Despite having no *cultural capital* in terms of experience in banking or microfinancing, the founders were determined to realise their idea of establishing interest-free loans, driven only by the moral obligation to eliminate *riba* through real actions. Based on the strong belief, or *habitus,* that their business was part of *dakwah* (propagation), BMT A's founders administered the project in a modest way, recording the disbursement and repayments manually as a form of accountability of staff to the founders. The identification of *capital, habitus, field* and *practice* of accountability and governance of BMT A during their first phase is illustrated in Figure 8-4.

Figure 8-4 The *capital, habitus, field,* and *accountability and governance practices* of BMT A during the micro-loan pilot development phase



Source: Author

BMT A's success in the micro-loan pilot project paved the way for the founders to move to the next phase of development and direction.

8.7.2. Phase 2 : Formalising the organisation

The increase in demand for interest-free loans signalled to the founders that it was possible to implement *shari'ah* principles in business and they wanted to broaden this project on a larger scale as part of *dakwah* in order to avoid *riba* (SD01). The limited *economic capital* hindered their ability to meet the increase in demand. From organisational growth theory, this marks the stage of crisis within the organisation, thus requiring the decision maker to establish a particular strategy to move forward from the crisis.

The founder's first strategy was to relocate the headquarters of BMT A to the village in which PPS was located in order to enable them to oversee the operations of the project more intensively, while seeking a solution to overcome the shortage in funding. Their first attempt to obtain a loan from the Islamic banks failed due to inability to provide collateral. After holding a series of *musyawarah*, the founders decided to optimise the legal form of BMT A as a cooperative. According the Cooperative Act No. 25/1992, cooperatives are allowed to mobilise funds from society. Moreover, the Act also stipulates that cooperatives should be equipped with structural bodies i.e. having a board of directors and management. Based on *musyawarah* and mutual agreement among the founders, two out of seven of the founders undertook the management functions while the rest acted as members of the board of directors. .

> *"We wanted to distribute the tasks so that the management focused on the daily operations, while the board of directors will be concerned with obtaining external support. The relationship between the management and board of directors was not as subordinates, but coordinates. Therefore, we mutually shared our tasks"* (SD01, SD06).

The management learnt that their previous lending system of not charging any profit was inappropriate for sustaining BMT A's operations in the long term. Accordingly, the management decided to adopt a business-like practice and improve the lending mechanism by setting a certain level of profit margin for the loans. This is permissible from the *shari'ah* perspective, as Islam allows profit to be gained in trade, provided that it is not excessive.[28] The level of profit margin was determined through *musyawarah*, which was based on a sense of fairness rather than business calculation in covering costs.

Unlike the previous lending system where all borrowers received the same amount of loan (single system loans), the new lending system allowed users to propose the loan amount they needed as long as it did not exceed the maximum threshold. Since no collateral was required from the borrowers and no selection criteria was in place in approving borrowers, the credit approval was largely based on the staff's personal relationship with the borrowers. Furthermore, the borrowers were also asked to save their money with BMT A on a regular basis so that it could be used as a reserve fund to pay out the loans. The new lending system in place helped BMT A to continue its operation in the long term as the profits from the loans were used to cover operational costs such as salary and administration costs as well utilised as revolving loans to facilitate more borrowers. Moreover, the savings requirement for borrowers brought two advantages for BMT A: it could be utilised as working capital or loans or as collateral when any defaults occurred.

Although the new lending system ran more smoothly, BMT A continued to experience shortage of funds due to the gap between the amount of savings and the demand for credit. The outcome of the *musyawarah* between the management and the board of directors was to invite people to become members of BMT A and they applied a membership contribution element in order to grow the fund. Therefore, the management and board members invited the PPS *kyai* to actively provide *dakwah* to

[28] As the Quran states "...do not consume one another's wealth unjustly but only [in lawful] business by mutual consent..." (The Quran. An-Nisa. 4: 29).

socialise economic *shari'ah* and introduced BMT A as an intermediary institution serving both the *shahibul maal* (the owners of capital) and the *mudharib* (people who run business and generate profit) with the profit distributed proportionally among the *shahibul maal,* the *mudharib* and BMT A based on *mudharabah* (profit-sharing) system. The PPS alumni and their networks were the principal target for gaining new memberships of BMT A:

> *"We used the emotional approach to obtain the additional capital by inviting the fellow members of PPS – teachers, santri and alumni – to become new members and persuaded them to deposit their money in BMT A. We did not promise any benefits of being a member, instead we affirmed that their contributions to BMT A were perceived as their submission and loyalty to PPS, which has nurtured them for years" (SD03).*

Through persistent *dakwah,* the number of BMT A's members, borrowers and depositors increased significantly. Accordingly, to enhance accountability and public trust, a manual recording system using three different books was implemented: a loan logbook, a passbook and a membership book. The records in the loan logbook indicate the dates of transactions, the borrowers' names, loan amounts, the repayment instalments, date of payments, and amount of outstanding loan. The records in the passbook indicate the date of transactions, the names of depositors, the deposit and withdrawal amounts and the balance, while the membership book comprises the personal data of members, the registration number, the date of registration and the membership fees. The staff continued to record the transactions in this way until they received training from the BMI regarding the different products offered by Islamic financial institutions, the management and application for saving and lending, the method to determine profit sharing, and the importance of financial reporting.

Following this training, BMT A started to improve its management method by adopting the profit-sharing method, selecting products that were applicable to BMT A, and preparing financial reports. For preparing the financial report, BMT A's management and the board decided to hire a staff who had gained work experience in cooperatives although his educational background was in engineering:

> *Although he was not a PPS alumnus, one of the founders knew him personally, so despite the fact that he has no expertise in accounting, we agreed to hire him (SD06).*

In fulfilling the duty to prepare financial reports, BMT A consulted *Dinas Koperasi* which provided a training session in basic accounting for cooperatives. However, the training was insufficient to aid staff in preparing financial reports but the staff were determined to prepare the financial reports despite encountering challenges, as explained by the operational manager:

> *"For many years we always made mistakes when preparing financial reports. We were unfamiliar with the accounting cycle, so we did not know how to correct the mistakes. Our focus was only on the balance between the money in and the money out; how much money we received from savings and how much money we spent on lending, operational costs and withdrawals"* (SD09).

Moreover, the preparation of financial reports was merely aimed to fulfil the accountability of BMT A to the government, as the Act No. 25/1992 concerning the cooperative stipulates that cooperatives must send their financial reports to the Office of Cooperatives. From the management's and board's perspective, the financial reports were less useful as they did not really understand but instead focused on the actual cash flow. They believed strongly that the fund was a form of trust from society and that they need to ensure that savers were able to withdraw their funds at anytime. The implementation of this new saving and lending system helped BMT A to grow significantly within just a few months and this further encouraged the management and the board to expand their *dakwah* through PPS's network of alumni in Pasuruan:

> *"PPS's kyai held silaturahim (visitations) with groups of PPS alumni, and they were advised to invite at least 20 other people to establish the branch of BMT A in their district" (SD08).*

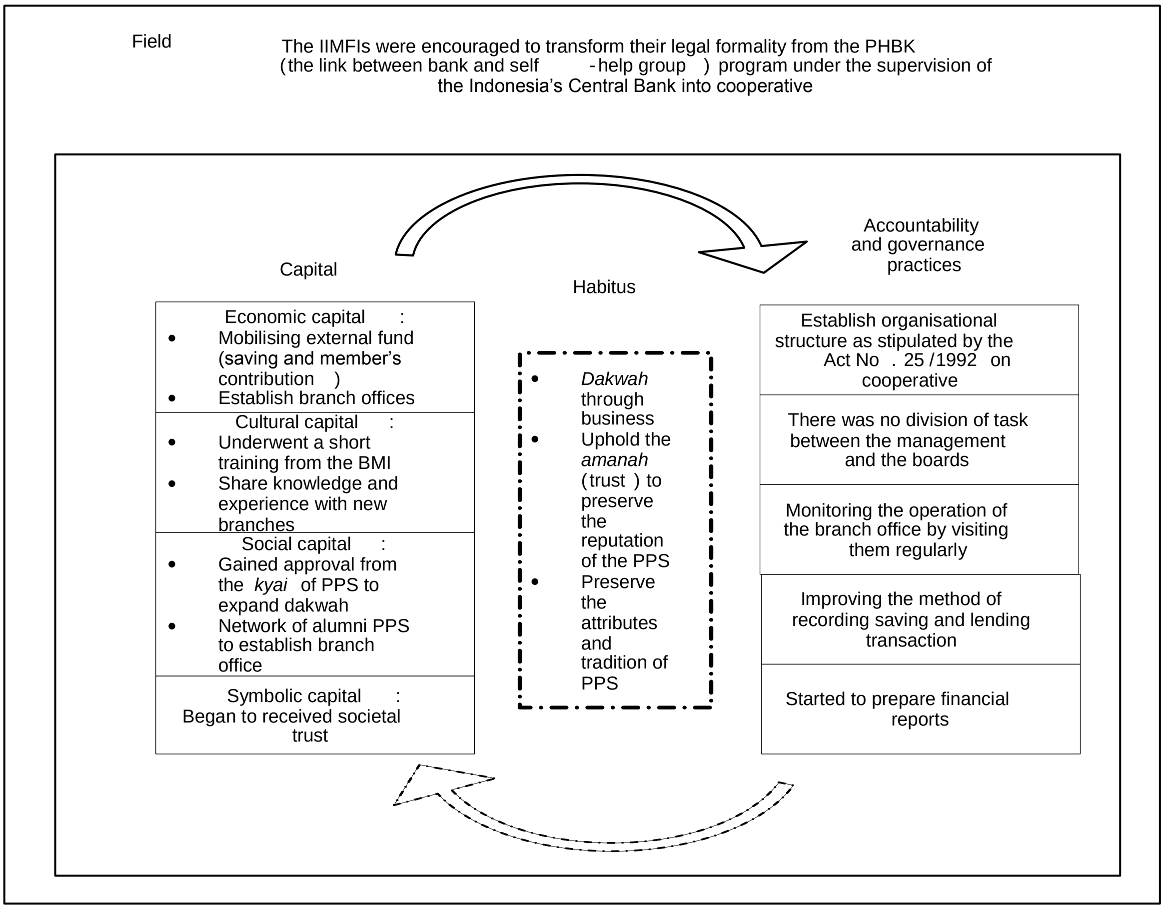
In convincing them, the *kyai* emphasised the *niat* (intention) for establishing BMT A was to serve society in getting them away from the *riba* system. Once the branch office had been established, members of the branch were required to hold *musyawarah* (discussions) to appoint staff. Furthermore, to support this establishment, the head office provided initial capital and invited the branch staff to observe the daily operation and work as an apprentice in the head office for a week. This is the experience of a former head of branch:

> *"We were invited to Pasuruan for a week to observe the operation of BMT A while they explained the products, how to market those products and how to record the transactions. We returned home and was given an initial capital of IDR 100 million to rent a place, buy the furniture and use the rest as working capital. We felt hesitant and confused about starting the business. During the first few weeks, I rang the head office almost every day for guidance. We managed to run the business and, Alhamdulillah (Praise to God), within three years, our current assets increased significantly from IDR 66 million to IDR 4 billion – almost 6,000%" (SD08)*

By implementing this strategy, 23 branch offices were established throughout the districts of *Pasuruan* within only two years. All the branches demonstrated a significant growth in assets as well as in the number of clients and depositors. The management and the board of BMT A supervised and monitored the operations of branch offices by visiting them regularly.

In short, BMT A moved into the second phase of organisational growth by formalising the organisation to develop the micro-loan project on a larger scale. In order to obtain the additional *economic capital*, it utilised the *symbolic capital* of PPS's charismatic *kyai* to invite the *social capital* of PPS's alumni to become members, to contribute membership savings and also become depositors. The increase in the volume of capital brought complexity to the operations which required BMT A to adopt new accountability and governance practices. The identification of *field, capital, habitus,* and accountability and governance *practice* in the second phase is summarised in Figure 8-5.

Figure 8-5 The *capital*, *habitus*, *field* and accountability and governance *practices* of BMT A during the organisation formalisation phase



Source: Author

8.7.3. Phase 3 : Expanding the business

BMT A moved into the outreach expansion phase when the management and the board decided to broaden the *dakwah* of *shari'ah* business outside of Pasuruan. However, the current operational licence allowed the business to operate only in the local area and this restricted BMT A from establishing branches out of this area.

At this point, BMT A encountered another organisational crisis that required the management and the board to adopt another strategy to move forward. They held *musyawarah* (discussions) and finally decided to change the area operational licence from the district level to the provincial level. Moreover, they also established a new cooperative called BMT AA to expand *dakwah* activities to a national level. Due to the massive accumulation of capital during this stage, the following sections further discuss the *capital* and accountability and governance *practices*.

8.7.3.1. The accumulation of different types of capital

The realisation of the expansion plan was made possible through empowering the network of PPS alumni to establish branches of BMT A and BMT AA in their area. The *economic capital* of both BMT A and BMT AA grew significantly as evidenced in the number of branch offices, funding sources, net income distributed to members, and the amount of *zakah* and donations to PPS.

By mid-2012, BMT A had 54 branches in East Java, while BMT AA had 181 throughout nine provinces (SD08, marketing manager). Moreover, during the period of 2006–2011, BMT A's profit increased six-fold, from IDR 1 billion to IDR 6 billion. In the same period, BMT AA's profit increased ten-fold, from about IDR 3 billion to IDR 43 billion. The increase in profit was followed by the increase of net income distributed to the members. In the case of BMT A, the amount increased from IDR 3.95 billion in 2010 to IDR 6.25 billion in 2011 (58% growth) while for BMT AA, it increased from IDR 11.58 billion in 2010 to IDR 18.00 billion (55 %) in 2011. The growth of BMT A's and BMT AA's assets, income and profit is illustrated in Table 8-1 and Table 8-2, respectively.

Table 8-1 BMT A: The growth of assets, income and profit for 2006–2011 (in IDR)

Year	Assets	Income	Profit
2006	24,234,880,723.47	94,937,019,873.74	1,119,778,790.73
2007	30,270,264,635.27	114,720,160,963.87	1,291,316,085.26
2008	43,768,266,114.76	159,273,736,160.33	1,752,285,887.69
2009	63,203,972,809.77	237,119,135,899.59	2,924,833,240.80
2010	89,138,192,945.88	344,359,981,487.36	4,172,796,045.59
2011	112,087,509,181.27	497,806,260,182.56	6,527,655,078.08

Source: BMT A

Table 8-2 BMT AA: The growth of assets, income and profit for 2006–2011 (in IDR)

Year	Assets	Income	Profit
2006	30,440,110,018.63	89,949,337,883.53	3,715,480,000.00
2007	51,672,554,640.78	180,959,115,919.24	6,724,750,000.00
2008	89,380,278,098.11	367,869,086,172.22	12,035,480,000.00
2009	133,242,408,136.04	607,417,475,291.20	19,423,830,000.00
2010	226,319,513,647.02	944,726,525,968.21	33,575,680,000.00
2011	406,198,718,754.49	1,825,057,422,991.60	43,374,040,000.00

Source: BMT AA

In terms of source of funding, besides the internal source through equity participations from members and lending activities, BMT A and BMT AA obtained their external source from the Islamic banks whereby loans were used as a reserve fund to maintain the organisations' level of liquidity. Another form of *economic capital* was the *zakah* and social fund allocated for PPS. The consolidation of *zakah* between BMT A and BMT AA in 2010 reached more than IDR 1.5 billion and they were distributed in the form of consumptive *zakah* which is mainly food for those in need, productive *zakah* aimed at funding activities in empowering people and *zakah* scholarships given to gifted but financially disadvantaged students. The social fund which was a donation allocated by BMT A and BMT AA for PPS reached more than 1 billion in 2010.

In terms of *cultural capital*, staff in BMT A and BMT AA had obtained knowledge and skills in the area of Islamic micro-finance through their own experiences during the first and second stages of growth, as discussed in the previous section. Their knowledge and skills were also obtained from the training sessions the management team undertook, which were held by a number of different institutions, which were then shared with colleagues through the internal training sessions conducted within BMT A and BMT AA. Another type of *cultural capital* is in terms of the products being offered by BMT A and BMT AA.

Whilst only general savings and lending (*qiradh*) were offered during the first and second stages, the types of products being offered increased after the staff attended training sessions on development of products, The saving products include general saving, *hajj* & umrah saving (pilgrimage saving), *eid fitr* & *eid adha* saving (Muslim celebrations) and student saving, while the lending products comprised of *mudharabah/qiradh* (profit and loss sharing), *murabahah* (cost plus), *ijarah* (leasing) or *rahn* (pawning). In developing the products, they follow the *fatwa* (legal pronouncement) of the *Dewan Syari'ah Nasional* (DSN – Shari'ah National Council), as explained by the marketing manager:

> *"We offered products as stipulated by the DSN, however, in reality we customised uqud (contracts) based on the demand and particular circumstances. Guided by the internal shari'ah board, we established an individual uqud as a solution to escape from riba transactions" (SD03)*

In other words, the process of accumulating the *cultural capital* of knowledge, skills and different types of products being offered within BMT A and BMT AA was conducted through both internal and external processes; internal process referring to the accumulation of *cultural capital* through self-learning while the external process through trainings received from external parties .

In terms of *social capital*, both BMT A and BMT AA have managed to broaden this capital by establishing relationships with a number of educational institutions, Islamic financial institutions and Islamic banksto provide training on various aspects of the business. Moreover, BMT A and BMT AA also joined the association of IIMFIs: the INKOPSYAH (the secondary cooperative at the national level), ABSINDO and PBMT (the association of IIMFIs), with the aim to share knowledge and experience with other IIMFIs, as well as to strengthen the position of IMFIs in Indonesia's financial landscape.

In terms of *symbolic capital*, BMT A and BMT AA received acknowledgements from a number of institutions. In 2010, a monthly magazine, *Investor*, awarded the biggest asset IIMFIs to BMT AA. In 2012, the Ministry of Cooperatives and Small Enterprise published *100 largest cooperatives in Indonesia* and posited BMT AA as the 3rd rank and BMT A at the 14th rank.

The interplay between different types of capital, as suggested by Bourdieu (1986), is clearly evidenced in this case study. The increase in the number of branches enabled more people being served by these institutions which increased their *social capital* and as well as *economic capital* due to the increase in the number of depositors. Similarly, the *social capital* in the form of BMT A's relationship with the Islamic banks, helped to improve their *economic capital*, as these banks provided the loans that were to be used for the reserve fund.

The relationship with other institutions also helped BMT A and BMT B to accumulate *cultural capital* in terms of knowledge, skills and the provision of different products. A wide range of products enabled clients or users to have more service options which in turn, increase the client base and consequently, increase their *economic capital*. Ultimately, the increase in *social capital, cultural capital* and *economic capital* promoted their position in the *field* through external acknowledgment of their achievements through the conferment of various awards as a form of *symbolic capital*. In short, during the expansion phase, both BMTs have accumulated different types of capital, and the magnitude of this capital enabled them to solidify their position in the *field* of Islamic microfinance in Indonesia.

8.7.3.2. Accountability and governance practices

As suggested by Bourdieu (1984), *practice* results from the relationship between *capital* and *habitus* within the social arena, or the *field*. Hence, accountability and governance practices in the expansion phase must reflect the changes in organisational *capital* and position in the *field*. When BMT A moved into the expansion phase, there was an almost simultaneous IIMFI movement in the *field* of Islamic microfinance.

This was marked by the establishment of the various associations of IIMFIs, as discussed in Chapter 7, which both BMT A and BMT AA joined to share knowledge and experience with other IIMFIs, as well as to strengthen IIMFI movement. Being a member of the association, both BMT A and BMT AA were able to broaden their social capital and improve their cultural capital, as explained earlier.

From the perspective of the founders of BMT A, the significant growth of *economic capital* has enhanced their confidence to expand the business as part of *dakwah* to fight against *riba*. However, they also acknowledged that this entailed greater *amanah* (trust) from the *ummah* (society). Therefore, they always reminded all staff to uphold *amanah* at all times. In other words, besides preserving the traditions of their lives at PPS in running the business as discussed in the section regarding *habitus*, the management and the board now also adopted a modern business practice approach, which affected their accountability and governance practices.

In terms of governance practices, both BMT A and BMT AA had to adhere to the requirements of the regulations. First, the founders established the organisational structure as outlined by the Cooperation Act No. 25/1999, which stipulated that cooperatives should comprise of two elements: the board of directors and the supervisory board, customised according to the organisation's needs (see Figure 8-3). In order to preserve the vision and mission of the organisation as a *dakwah* institution rather than solely a business entity, the seven founders were split between BMT A and BMT AA, and became the board members and the management team. The appointment of the board members and the management team was based on the *musyawarah* (consultation) to achieve *mufakat* (consensus) among the founders. However, when BMT A and BMT AA started to hold their annual general assembly, as stipulated by the Cooperation Act, the members of the board were voted in by the members of the organisation. The number of board members was agreed during the annual general assemby and they were elected (and could be re-elected) every three years. As the secretary of the board explained:

> *"The members of the board of directors have changed over the last ten years. At the beginning, there were only three members: the chairman, the secretary and treasurer. Then it increased by one member – the vice chairman – and recently, the position of vice chairman was changed to become two members. So in total, we now have five members of the board of directors. We also elected three members for the supervisory board: the shari'ah board member, the finance supervisor and the management supervisor" (SD05).*

The election mechanism was conducted through two stages. The first stage involves nomination of potential candidates and this was normally based on candidates deemed most trustworthy among the members. In the second stage, each member is allowed to vote for one of the nominees. The candidate with the most votes will be appointed as the chairman of the board and he is required to hold *musyawarah* promptly with the other seven top nominees to determine their positions on the board. The chairman would then announce the agreement and ask for approval from the members on the people appointed and their positions within the board. If there were any objections from the members, the chairman of the board will need to reconsider willing to switch the position until all the members were satisfied with the arrangement.

Secondly, the organisational structure for the branch offices (see Figure 8-2) was also established with the delegation of some authority, such as the approval of a maximum loan of IDR 50 million. Branches are now considered as profit centres with responsibility for generating revenues and bearing the costs incurred, and their performance evaluated through the achievement of profit targets set by the head office. Although the branches had independence in the day-to-day operations, such as selecting clients and controlling expenses, they had limited authority when it comes to the recruitment of new members or branch staff and their salaries, as these were set by the head office. Branches were not allowed to establish collaborations with third parties, including opening bank accounts with the Islamic bank. In short, the management of BMT A and BMT AA is generally deemed as being centralised rather than decentralised.

Thirdly, in order to improve the quality of internal management, the standard operation management (SOM) and the standard operation procedure (SOP) documents were used as guidelines for the management of operations and a wide range of operational procedures, such as the procedures for opening savings account, depositing money, withdrawing money, applying for a loan, and repaying a loan and various forms were made available to keep track of transactions. There was also clearer job description for each role. The documentation and formalisation of procedures helped to standardize the services provided by the organisation’s various branches.

Fourthly, in monitoring and supervising the performance of each branch, board members or the head office management team frequently make unannounced visits to the branch offices, checking that actual cash balanced with the accounting records. Any discrepancy discovered will be investigated promptly. However, the rapid increase in the number of branches later made it impossible for the board members and the management to visit all the different branches on a regular basis. Therefore, they appointed a representative committee chosen based on seniority among the PPS alumni. The function of this committee was to represent the board in monitoring the operations of the branches. In evaluating the performance of the branch offices, the head office adopted financial ratio indicators, such as CAR (Capital Adequacy Ratio), ROE (Return on Equity), ROA (Return on Asset), cash ratio, efficiency ratio and net profit margin. Furthermore, the general manager holds monthly meetings with all heads of branch to evaluate their financial performance by comparing their profit targets with their actual achievements, as well as sharing their experiences and the challenges.

Fifthly, the division of tasks between the board members and the management was however less clear as they jointly monitor and supervise the organisation. A duty roster of the particular board member or manager in charge for the each day was set. Weekly meetings were held and attended by the board of directors, the supervisory board and the management team (general manager, marketing manager, human resources manager and IT manager). The secretary of the board prepared the minutes so that the recommendations made during the meetings could be followed up. The aim of the meetings was to discuss the issues/problems they encountered, to establish an action plan for the development of the organisation, to approve investment decisions and to evaluate loan applications of more than IDR 100 million. The final decision in recruiting members of staff for the managerial and branch offices was appointed during these meetings.

> *"During the meeting, we discussed mainly the strategies to be adopted for organisational development. However, we were also asked to handle any operational problems such as bad credit that required the intervention from the boards or management"* (SD05).

The decision-making process was made collectively through *musyawarah mufakat* (discussions to achieve agreement), as explained by the secretary of the board:

> *"Musyawarah is the spirit of Islam. As exemplified by the Prophet, in making a decision, he always asked the opinion of his sahabi (companion), with whom he had a discussion in order to decide on the best option"* (SD 05)

Sixthly, the presence of the *shari'ah* supervisory board (SSB) is the main characteristic that distinguishes IMFIs from conventional MFIs, as stipulated in the Ministerial Decree of the Ministry of Cooperative No. 91/Kep/M/ KUKM/IX/2004 concerning the guideline practices for Islamic financial cooperatives. BMT A and BMT AA's SSBs were voted on during the AGM, and were selected based on their expertise in *fiqh muamalah*. The primary role of the SSB was to ensure that products and services were in accordance with *shari'ah* principle.

> *"The role of the SSB was to provide advice in case we encountered problems about which we hesitated because the solutions may not have been in accordance with shari'ah principle. Moreover, the SSB also gathered information from*

> *clients who may have complained that our services or products deviated from the fiqh muamalah"* (SD01).

The SSB also played a role to encourage members of staff, the board and the management team to run the business by upholding *amanah*. On many occasions, such as *pengajian* (public sermon) and *istighosah* (seeking relief), the SSB reminded the staff to perform *muhasabah* (self-reflection) about whether or not their duties had been carried out properly, and whether or not they have infringed on or inflicted harm on their colleagues or customers. In this way, the members of staff were reminded that the businesses they run should be seen as a medium for *dakwah*, rather than for merely generating profit, and should therefore be operated in the interests of the *ummah*.

In order to improve accountability, BMT A and BMT AA have adopted a number of practices, as follows. First, the manual recording system was replaced by a computerised system by installing a software application to record all transactions and generate financial reports. The implementation of this method brings several benefits: 1) improve accuracy and reliability, and reduce errors in recording transactions; 2) facilitate the preparation of financial reports from branch offices; and 3) make it easy to find certain transactions in case of an error being found.

> *"The previous system was replaced by the computerised system, and before that I was struggling to prepare financial reports. I spent about two months preparing them. Moreover, I have anxiety on the financial reports I prepared, about whether it was right or wrong. The reports were prepared mainly to fulfil the obligations of reporting to the Cooperative Office"* (SD09).

> *"For two years before the computerised system was introduced, I had to work overtime, sometimes until midnight, to manually calculate the profit-sharing figures, although we have only 100 clients"* (SD02, SD12)

Despite the branch system being computerised, the system was still not connected with other branches or head office. Therefore, the branches sent a soft copy of their financial report to the head office every month for it to be consolidated with other branch reports.

Secondly, was the improvement of daily operations within the branches for both savings and loan activities. When it came to savings activities, the depositors were given a printed savings passbook so that they could check their savings. Since a majority of their depositors were vendors who traded at the traditional market, a member of staff walked around the market every day and collected savings deposits from them. The staff were equipped with a payment machine that was linked to the branch database and could produce two receipts – one for the company and one for the trader. When the staff returned to the branch, he gave the money and receipt to the cashier, who would check the deposit amount against the receipt. At the end of each day, the cashier will print the daily cash flow and submit it to the head of branch for checking that the amount of cash tallied with the report. If there was any difference, the head of the branch will ask the staff to double check. If there was still an issue, he would investigate the matter promptly, and if cashier had made a mistake, they would be responsible for reimbursing the difference.

When it comes to loan activities, a number of policies and practices were adopted to improve the accountability of the creditor as well as the member of staff, by 1) asking for collateral, such as a certificate of ownership of vehicles, land or house, for loans of more than IDR 500,000; and 2) evaluating the feasibility of potential creditors, including a survey of their business in order to prevent any future defaults.

The staff member would report the result of the survey and give his assessment for approval to the headquarters. If the application was approved and the loan was going to be more than IDR 500,000, the staff member proceeded to check the collateral, followed by the drawing up of an *uqud* (contract), and the transfer of the loan to the creditor. The staff who recommended the creditor would be responsible for monitoring the loan payment until it was entirely paid off. If there was a default, the staff used a soft approach of visiting (*silaturrahim*) the creditors in person and reminding them of their obligations, rather than sending a formal notification in writing. For late payments, BMT A did not charge any fines because the *fatwa* of the *shari'ah* board of BMT A forbade such practice.

> *"Fiqh muamalah allow us to charge fines if it meets three criteria: any charge was predetermined at the beginning; the creditor was truly incapable of paying due to some uncontrollable circumstances; and that the fines should be allocated to a social fund and not recorded as part of income. However, the supervisory board prohibited us from charging fines, and emphasised that we should adopt the personal soft approach, as the business they were running was part of dakwah. Therefore, they should encourage people to be aware of their obligations"* (SD03).

Thirdly, BMT A and BMT AA also started to prepare budgets. The budgeting process adopted a top-down approach whereby a budget was prepared by the board and the management team without involving the heads of branch. The budget was set by calculating the percentage increase from previous performance, and the revenue and expense budgets were broken down proportionally for each branch. The branch office budget was used to evaluate performance and to motivate the heads of branch to achieve their set targets. During the monthly meetings, the managers announced which branch performed the best, in terms of meeting and/or exceeding their target, with bonuses being given to all staff in the winning branch.

Fourthly, an independent auditor began to audit the consolidated financial report due to the fact that this was a requirement of Islamic banks for loan application purposes.

> *"When applying for loan from an Islamic bank, the regulation required us to provide an audited financial report. So far, our financial report has been audited twice, in 2010 and 2011, with the result of unqualified opinion"* (SD09).

Later, the audited financial report was also used for tax calculation purposes and for discharging accountability to the members of the organisation. The audit report was attached in the annual report that was published and distributed to members in the annual general assembly.

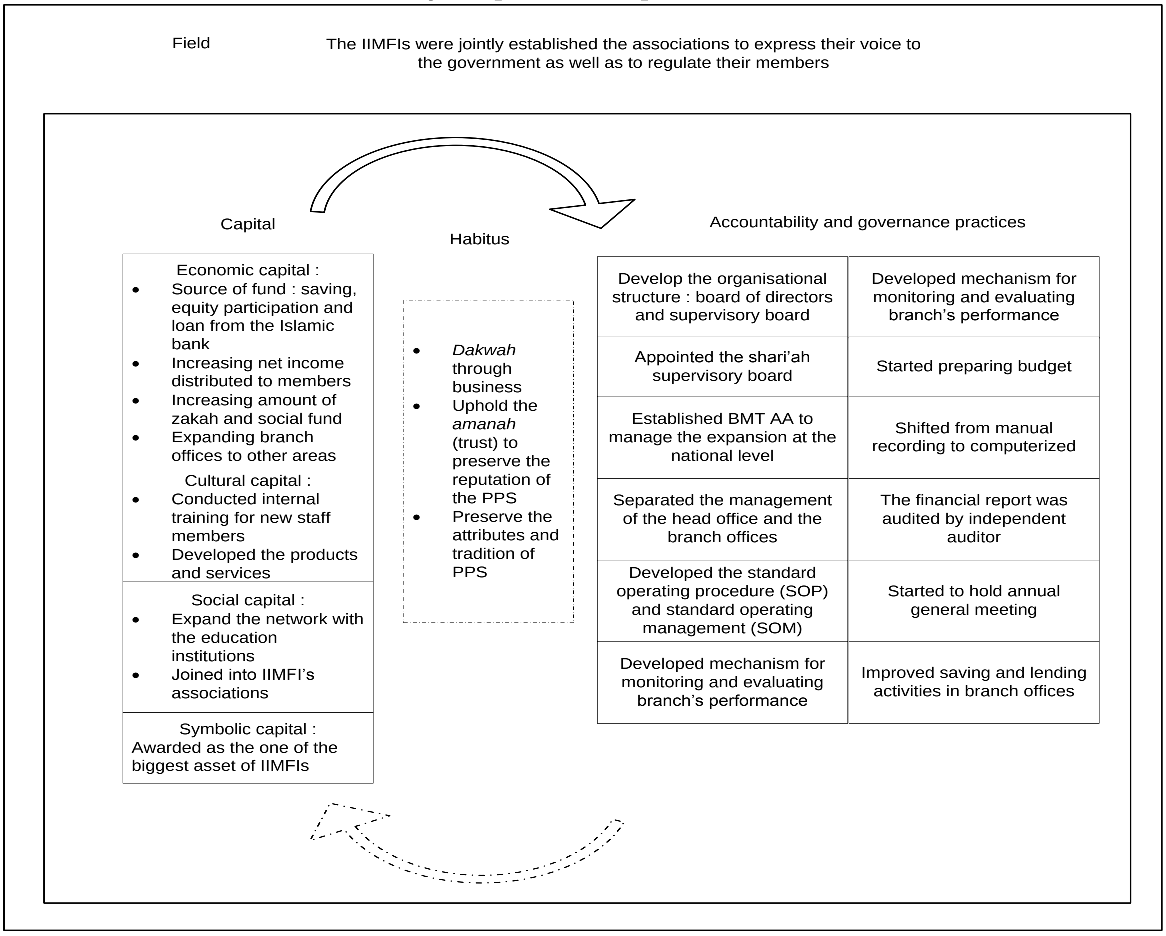
> *"For members, the most important was that the net income distributed to them continually increased. In the annual general assembly, I reported the growth and progress as well as details of the utilisation of funds. I also emphasised that the report had been audited by the external auditor, which means that the report has been checked by independent external parties" (SD06).*

Lastly, as stipulated in Act No. 25/1992 concerning cooperatives, the board is required to hold a general assembly at least once a year. In 2004, BMT A held its first annual general assembly, and the schedule was established either on the last Friday of January (if the meeting was to be held at PPS, because Friday is a weekend holiday) or the last Sunday of January (if the meeting was not to be held at PPS). All registered members were invited. Since 2009, when membership exceeded one thousand members, the assembly was held at the stadium in Pasuruan. The assembly was a presentation regarding the accountability of the board of directors and the supervisory board.

During the assembly, the board of directors outlined the organisation's activities and achievement during the year, comprising 1) managerial activities, such as the establishment of new branches, cooperation with external parties, and the number of members; 2) administration activities, such as documentation of job descriptions, SOP and improvements to administration; 3) the evaluation and achievement of programs devised during the previous annual assembly; 4) financial reports, including a balance sheet and profit and loss statement; and 5) the budget and a plan of activities for the next year. Similarly, the SSB also explained the monitoring activities that had been carried out during the year as well as their findings and suggestions for the board of directors in improving the organisation's performance. Since 2010, the board's annual report has been printed and distributed to the members prior to the assembly, so that they can read it and raise any questions if necessary.

In short, the third phase which involves business expansion at both the regional and national levels, resulted in massive accumulation of capital, which was followed by the development of the organisation's accountability and governance practices. At the same time and at a national level, IIMFIs came together to establish the associations of IMFIs, with the aim of regulating their members and voicing their interest as part of a group of financial institutions that were being overlooked by the government. The identification of *field, capital, habitus,* and accountability and governance *practice* is illustrated in Figure 8-6.

Figure 8-6 The *capital*, *habitus*, *field* and accountability and governance *practices* during the phase of expansion



Source: Author

8.8. Summary and conclusion

This chapter presented the empirical findings regarding the way in which accountability and governance is developed and practiced in BMT A. Adopting Bourdieu's theory of practise, it is suggested that such practices were informed by different types of *capital* and *habitus* within the social arena (*field*). Following this concept, *habitus* is the central and indispensible concept discussed in the first section. Since organisational *habitus* is influenced by the organisation's history, this aspect was described in detail. The religious practice that was taught during the employees' school lives at PPS has created moral behaviours and the perception that business is a medium for *dakwah* rather than for profit. Moreover, the way they were nurtured for years at PPS engendered the awareness that PPS was not merely an institution, but part of their identity that should be upheld at all times. Therefore, they had preserved PPS's rituals, practices and customs during their career at PPS as a spiritual fortress to prevent them from being greedy in business. These moral behaviours, or *habitus*, have permeated and steered BMT A in managing and developing its business to the present stage.

The findings show that accountability and governance practices are dynamic rather than static due to the change in the *capital* held by the organisation as it grew. BMT A has evolved in three different phases: developing the micro-loan pilot project, formalising the organisation, and expanding the business. In the first phase, BMT A started with a limited funding source and no experience in Islamic finance adopting a trial and error method when it came to its administration activities. Therefore, relatively no accountability or governance practices were adopted due to the fact that the founders focused more on introducing and implementing the pilot project.

When the project was proven a success, as indicated by the increasing number of clients, the founders decided to develop the pilot project into a more formal business in order to help even more poor people. This required significant additional *economic capital*. Supported by PPS's *kyai* to invite PPS alumni to participate in developing a *shari'ah*-compliant business, BMT A started to mobilise funds and collect savings from their clients. The increase in volume of economic capital required BMT A to formalise the organisation and it began to adopt business-like practices. The success story in this phase then inspired the founders to expand *dakwah* to other places, both at the regional and national levels. During this phase, massive accumulation of *capital* took place, which required BMT A to develop a number of accountability and governance practices. During this phase, BMT A evolved its business from being a small micro-loan project to being one of the biggest IIMFIs in Indonesia.

Due to the dynamic features of accountability and governance practice, there is no single practice that fits all organisations. Moreover, accountability and governance is socially constructed, therefore history and context informs the development of accountability and governance practices. Therefore, the next chapter discusses the accountability and governance practices in BTM B that have different characteristics to those employed by BMT A. To summarise, the identification of the *capital* and *habitus* of BMT A that have affected its accountability practices during the three phases of its growth is presented in Figure 8-7.

Figure 8-7 The development of *capital*, *habitus* and accountability and governance *practices*

Field
(Discussed in the chapter 7)

Age of organization

Organizational growth / Bourdieu's concept		Phase 1 Creativity	Phase 2 Direction	Phase 3 Delegation
		Started pilot project for micro-loan	Established formal organization	Expanded the business
Capital	Economic	Source of fund only from donation	Start to mobilise fund/ collect saving	Economic capital grow significantly
Capital	Cultural	No experience on microfinance	Acquire short training on microfinance	Have experience in managing Islamic microfinance
Capital	Social	Small number of teachers in PPS	Gain approval from kyai and supports from the alumni	Wider the networks with external parties
Capital	Symbolic	N/A	Begin receiving trust from society	Awarded as one of the best and the biggest IMFIs
Habitus		Perception toward business, the loyalty toward PPS, organizational customs and attributes, the ritual and religious practices		
Accountability and governance practices		• Manual and simple record keeping • Accountability focus on financial, conducted informally to founders • No organizational structure	• Begin to adopt business-like practice • Start to prepare financial reports • Simple organizational structure	• Formalized procedures • Begin to focus on monitoring and supervision • Enlarge the organizational structure

External challenges

- The regulations are obscure
- No supervision from the government
- Business competition

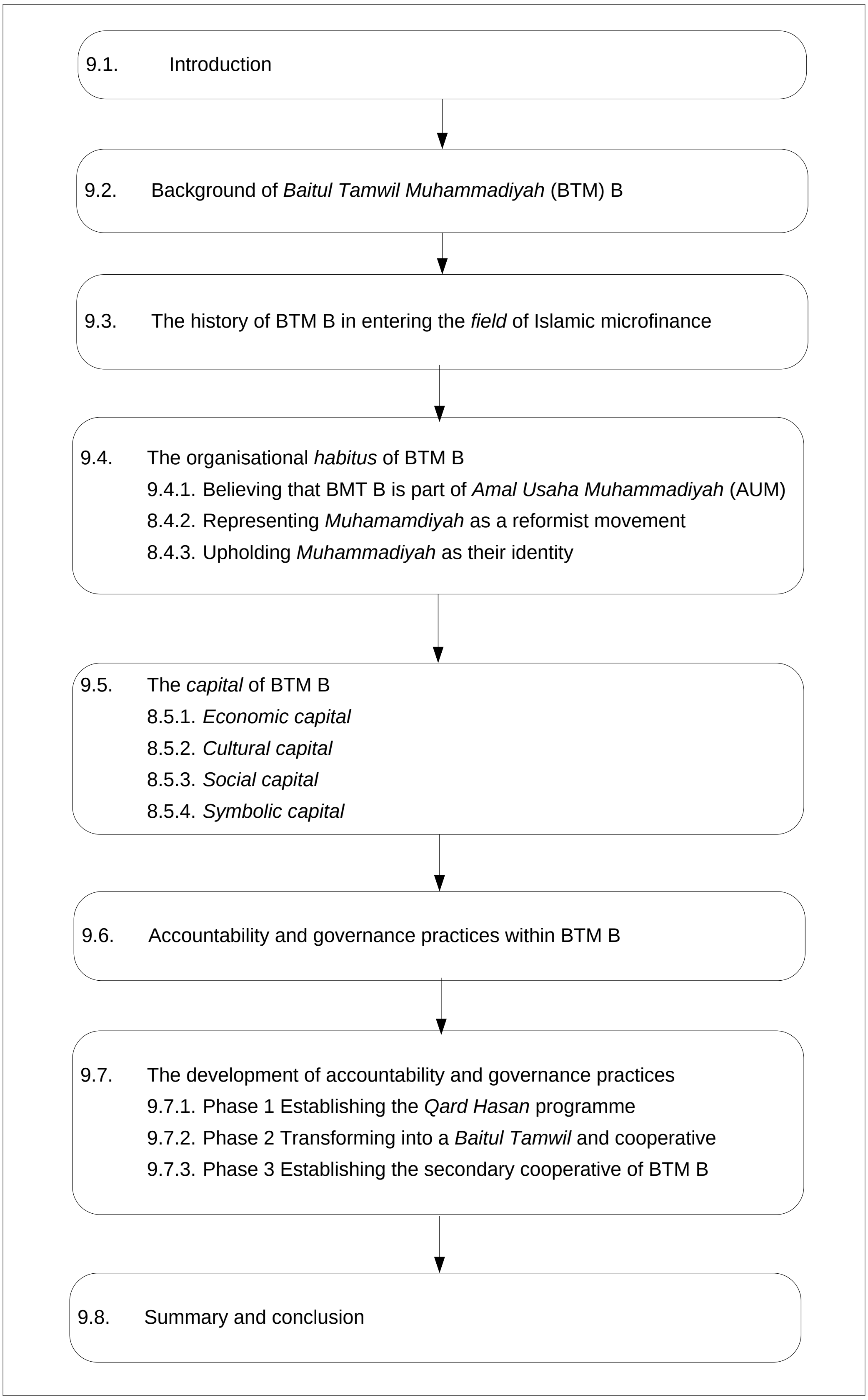
Source : Author

CHAPTER 9 CAPITAL, HABITUS AND THEIR INFLUENCE ON ACCOUNTABILITY AND GOVERNANCE PRACTICES IN BTM B

9.1. Introduction

The previous chapter discussed the construction and development of accountability and governance practices in BMT A. This chapter presents the findings of accountability and governance *practices* in BTM B, the second empirical site. The discussion in this chapter is divided into seven sections. The first section briefly provides the general background of BTM B, followed by its history in entering the *field* of Islamic financial services. Section 9.4 identifies the organisational *habitus* of BTM B that is demonstrated in the generation of accountability and governance *practices*. Section 9.5 explains the types of *capital* that BTM B possesses, while Section 9.6 discusses the construction and development of accountability and governance *practices*, followed by a summary and conclusions in Section 9.7. The structure of Chapter 9 is presented in Figure 9-1.

Figure 9-1 The structure of Chapter 9



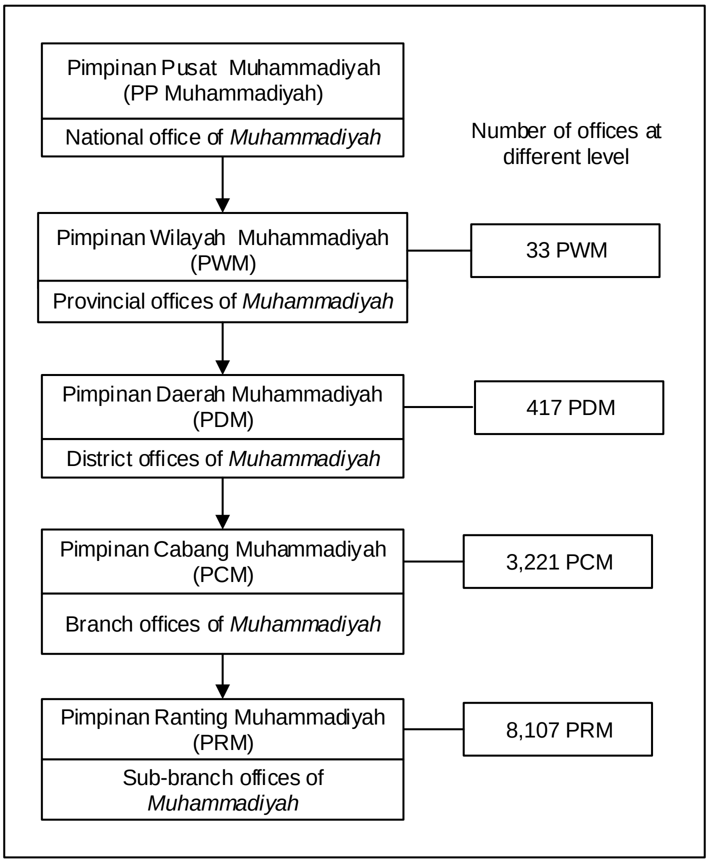
9.2. Background of *Baitul Tamwil Muhammadiyah* (BTM) B

Discussion of the profile of BTM B is inseparable from discussion of the organisational vision, the financing mode and the organisational structure of *Persyarikatan Muhammadiyah* (*Persyarikatan* literally means organisation), the second biggest Islamic mass organisation in Indonesia.

As discussed in Chapter 4, *Muhammadiyah* was established to overcome acute poverty through promoting social welfare by providing education, health services and orphanages underpinned by Islamic values. The entities provide services under the name of *Amal Usaha Muhammadiyah* (AUM) (Pimpinan Pusat Muhammadiyah, 2014). The term *amal usaha* is derived from a combination of *amal* (an Arabic word), which literally means benevolence, and *usaha* (an Indonesian word), which means economic activities. So *amal usaha* refers to economic activities as a medium of worship to support the *dakwah* (Islamic propagation) of *Muhammadiyah*. As stipulated in the *Muhammadiyah Charter*, the aim of *Muhammadiyah* is to uphold Islamic tenets in order to build a truly Islamic society through *Da'wah Amar Ma'ruf Nahi Munkar* (promoting the virtuous and forbidding the wrong) and *Tajdid* (renewal to purify society), which are incorporated in various programs and activities.

In terms of financing, *Muhammadiyah* has demonstrated financial independence throughout its history. At the beginning of its establishment, its activities were financed by the founder from his trading profit (Maarif, 2001). When *Muhammadiyah* started to expand its activities to Sumatera island in the 1920s, the expansion was funded by different means: membership fees, religious alms (*zakah*), religious endowments (*waqf*) and lucrative economic activities (Njoto-Feillard, 2014). These modes of financing have been inherited in the financing of *Muhammadiyah's* activities until the present day, particularly through its productive sector such as AUM. As discussed in Chapter 4, the owner of AUM is the *Persyarikatan* Muhammadiyah, covering different levels: national office, provincial offices, district offices, branch offices and sub-branch offices. The hierarchy of *Muhammadiyah's* organisational structure is presented in Figure 9-2.

Figure 9-2 The hierarchy of the organisational structure of *Muhammadiyah* and the number of offices at the different levels



Source: Author, modified from PP Muhammadiyah (2014)

The national office established the rules regarding the hierarchy of ownership of the AUM. In the education sector, for example, kindergartens belong to the *Aisyiyah* (an autonomous organisation for women) of the *Muhammadiyah* branch office, elementary schools belong to the *Muhammadiyah* at district level, and the junior and high schools belong to the *Muhammadiyah* at the provincial level. In the health service sector, only district offices and above are allowed to manage health services. The same framework was established in other areas of AUM, such as orphanages and economic activities. In fact, this regulation is not too strict, as the lower offices and personnel still have the freedom to establish programs and activities, including fundraising (WR03).

BTM B is an AUM of *Pimpinan Cabang Muhammadiyah* (PCM – Muhammadiyah's branch offices) in sub-district B in the city of Pekalongan, Central Java. Pekalongan is well known as the city where Javanese *batik* attire is produced, and the centre of production is located in the sub-district where BTM B operates. The population of this sub-district is about 56,000, mainly from the Javanese ethnic group, with the majority involved in trading (Pekalongan, 2014). The office of BTM B is situated in the centre of the sub-district by the side of the main road that connects the cities of Semarang and Jakarta. The modern three-level building with a big logo of *Muhammadiyah* at the top front of the building is visible from afar with its blue paint, a colour that is always associated with *Muhammadiyah*.

The logo of *Muhammadiyah* as presented in Figure 9-3 resembles a bright, shining sun with 12 rays that represents purity and excellence, with the Arabic word '*Muhammadiyah'* in the centre. Surrounding the word is the *Kalimah Syahadah* of '*Asyhadu allaa ilaaha illAllah wa asyhadu anna Muhammadar Rasulullah*', which means 'I bear witness that there is no God but Allah and the Prophet Muhammad is His messenger'. The sun is the centre of the solar system and the source of energy of a living organism, therefore *Muhammadiyah* and its infrastructure are expected to become the source of spiritual power for the *ummah* (society).

Figure 9-3 The logo of *Muhammadiyah*

Source: PP *Muhammadiyah* (2014)

9.3. The history of BTM B in entering the *field* of microfinance institutions

The idea of establishing BTM B came from two men from the sub-district of the city of Pekalongan, who are active members of *Muhammadiyah* and were passionate about implementing *shari'ah* in business when they graduated from university. Both graduated from the Faculty of Economics, one from the *Walisongo* Islamic State University, Semarang and the other from the Indonesian Islamic University, Yogjakarta, where they were both taught Islamic economics. Up to the present, the senior man has been acting as the chairman of the boards (code as WR02) and the junior is the manager of BTM B (code as WR01).

Their idea was not realised until WR02 was appointed as the financial consultant for a large company that is owned by a reputable and rich family and is also a member of

Muhammadiyah in Pekalongan. This company had set up a foundation to spread *dakwah* through social activities. As a financial consultant, WR02 proposed to the foundation an empowerment program to help the traditional roof-tile makers in a village in the south of Pekalongan. The economic conditions in this area were similar to those of the women bamboo furniture makers in the village in Bangladesh where Grameen Bank was set up; that is, they were paying high interest on loans, which trapped them in the bonded labour system for years. The roof-tile makers borrowed money from middlemen and had to surrender their products to the lenders as payment. In this case, the price of the products was determined by the middleman. Almost no profit could be generated from their work; consequently, they ended up still living in poverty. Therefore, WR02 proposed that the foundation provide interest-free rolling loans.

> *I have access to financial resources to help the roof-tile makers. I wanted to introduce interest-free loans for them, but I did not have anyone who is able to run this program. (WR02)*

To run this program, WR02 nominated WR01, whom he had known for a long period. At the time, WR01 was a student at the Islamic State University, but did not have experience in implementing *shari'ah* in business. Therefore, WR02 sponsored him to attend *shari'ah* business training at *Baitul Tamwil Teknosa* at the Bandung Institute of Technology, the institution deemed to be the first IIMFI in Indonesia, as discussed in Chapter 7. Returning from a week's training at *Teknosa* in the middle of 1987, WR01 quickly set up an interest-free loan program for the roof-tile makers.

He adopted the *mudarabah* financing model, a contractual relationship between the owner (*rabbulmal*) who supplies capital and the manager (*mudarib*) who supplies labour and skills. In this scheme, the roof-tile makers were provided with capital to cover their cost of production. Then when the products were sold, the difference between sales and the cost of production was shared equally between them in the program. They were also encouraged to retain some portion of the profit as savings, which could be withdrawn after a certain period. The program ran smoothly for a few years and had a significant impact in assisting the villagers to gradually exit from their usurious loans and poverty. However, it was discontinued after the government prohibited the production of traditional roof tiles due to environmental sustainability reasons and the tile makers were relocated to different places.

> *One of the roof-tile makers testified that by following this program, he can afford to buy a bicycle, a mattress and books for the children. It was something that he has never experienced before. This experience has made me realise that the profit and loss sharing system is capable of creating benefits as long as both parties uphold truthfulness in running the business. (WR02)*

Based on this success in developing a financial program for the poor, WR02 was entrusted with establishing *Bank Perkreditan Rakyat/BPR* (People's Credit Bank), following the financial regulation of Pakto '88 (*Paket Oktober* – October Package) that facilitated the establishment of rural banks, as discussed in Chapter 7. However, BPR was interest based, as the *shari'ah* system was less well known during this period. Following the discontinuation of the loan program for the traditional roof-tile makers, WR01 was then hired by BPR in 1990. Later, the experience acquired at BPR was beneficial in developing BTM B.

At the beginning of 1995, the chairman of PCM B invited WR01 and WR02 to join him. They were required to seek a financing mode that was able to support *dakwah* and PCM B's programs. As explained in the previous section, the national office of

Muhammadiyah gives autonomy to lower-level offices (decentralisation) to manage programs and activities, including financing their programs. Usually, when PCM B plans programs such as mosque renovation, it prepares a proposal and distributes it to members of *Muhammadiyah* to seek donations. Very often, the amount of donations is less than the funds required, as donations are voluntary. Such fluctuating finance is problematic, as the funding resource is difficult to estimate precisely and the sustainability of donations is questionable. Consequently, many planned programs have to be either terminated or postponed due to lack of funding.

Following this request and as a demonstration of the moral responsibility of being members of *Muhammadiyah*, WR01 and WR02 established *Baitul Maal* of *Muhammadiyah* (BMM). As discussed in Chapter 4, the *Baitul Maal* or house of treasure/money is aimed at accumulating *zakah* (a religious tax) and utilising it for public purposes. To start with, they identified the sources of funds and classified them into two categories: regular such as *infaq* (fixed donation) and *zakah* (alms giving), and irregular such as *sedekah/sadaqah* (donation), *hadiah* (gift) and *waqf* (religious endowment). To mobilise the regular funds, WR01 and WR02 collaborated with the sub-branch offices by holding *pengajian* (communal *Quran* recitations) and reminded attendees of the obligation of *zakah* as well as giving advantages of *infaq* and *sadaqah*. During the *pengajian*, the *infaq* box was passed around and members were encouraged to donate. The *pengajian*, which were held every week in various places, resulted in a gradual increase in funds.

The fund was managed and disbursed carefully. The *zakah* fund was distributed to the eight beneficiary groups as stipulated in the *fiqh* (Islamic jurisprudence), while the donation fund was distributed to their poor members for 1) consumption activities: cash donations, paying for health treatments; 2) productive activities: scholarships for children, providing capital to empower economic activities; and 3) renovation facilities: mosque, *madrasah* (schools) and offices. The BMM ran smoothly and enabled PCM B to become financially independent to finance its programs.

The success story attracted the attention of another member of *Muhammadiyah* from this village, who was the Police General in Jakarta. At the beginning of 1996, he donated IDR 25 million[29] *waqf* and required it to be managed as a revolving fund to help the poor. *Waqf* or *awqaf* (the plural) is a donation, but has specific characteristics: 1) *waqf* should be perpetual in nature or should be in the form of fixed assets; 2) the owner of the property declares the intention of the donation, which cannot be revoked; and 3) *waqf* properties are not meant for sale, disposal, mortgage, gift or inheritance (Osman, 2011). Therefore, due to the nature of *waqf*, WR01 and WR02 decided to manage the fund separately from the BMM. They formulated a mechanism to distribute the fund based on *qard hasan* (virtuous loan), whereby the borrowers are required to pay the loan back with the same amount. The idea was proposed to the PCM B and was approved at the board meeting held on 5 January 1996.

[29]About GBP 1,268, exchange rate then being 1 GBP = IDR 19,702 (1st May 2015)

9.4. The organisational *habitus* of BTM B

As discussed in Chapter 5, *habitus* is a result of the socialisation of past educational or social background that shapes actions. Therefore, the organisational *habitus* of BTM B was primarily inculcated through involvement as active members of *Muhammadiyah*. By active involvement, the values of *Muhammadiyah* as discussed in Chapter 4 have shaped the moral disposition of BTM B. This was manifested through the belief that BTM B is a business entity owned by *Muhammadiyah*. Consequently, the objective of BTM B is none other than to support the *dakwah* of *Muhammadiyah*. Moreover, the characterisation of *Muhammadiyah* as a modernist and reformist movement, as discussed in Chapter 4, has been embedded in its practice. BTM B always positions its movements as distinct from other IIMFIs, as it adopts the concept of 'business-like' practice in its operations. Details of each *habitus* will be discussed in depth in the next sections.

9.4.1. Believing that BTM B is part of *Amal Usaha Muhammadiyah* (AUM)

As discussed in the previous section, the idea of establishing interest-free financial institutions emerged from the enthusiasm of two young cadres of *Muhammadiyah* in Pekalongan. They wanted to implement *shari'ah* in business, a subject that they learnt from the Faculty of Economics of Islamic University, in real life. Their idea only came to fruition when they were entrusted with managing a *waqf* fund of IDR 25 million. They utilised the fund for productive activities by adopting a *qard hasan* (virtuous loan) model. From the beginning, to administer the *qard hasan,* the founders set up an independent organisation that is separate from the *Baitul Maal of Muhammadiyah* (BMM). Instead, such an institution is intended as part of AUM and belongs to PCM B. Consequently, the previous empowerment program of BMM was no longer available and it was merged into the *qard hasan*.

The reason for setting up the *qard hasan* as part of AUM is that the program is intended to provide a significant contribution to *Muhammadiyah*. The founders learnt from past experience that in many cases the 'brand name' of *Muhammadiyah* was utilised for individual interest in the short term, without contributions and benefits for *Muhammadiyah* as an institution. For example, there are a number of schools and health services operating under the name of *Muhammadiyah*, which was used as a 'rubber stamp' to legitimise their activities and gain societal trust. When they grow and became big institutions, they declare themselves as independent, separate from *Muhammadiyah*. However, when such an institution fails or collapses, *Muhammadiyah* has to accept the risk of its reputation being undermined as one of the biggest Islamic organisations in Indonesia. As the founder explained:

> *I have been a member of Muhammadiyah since I was young and I observed how Muhammadiyah has been exploited by irresponsible people. It is not fair. If Muhammadiyah is considered as the owner, it should have authority to manage and receive some portion of the profit. There should be a balance between benefits and risks encountered by Muhammadiyah. (SD02)*

Later, when the *qard hasan* had demonstrated its growth and development, the founders transformed this program into a more-business oriented organisation, which became BTM B. In attempting to prevent the abuse of *Muhammadiyah* in the future, WR01 and WR02 established a framework to guide the operations of BTM B, as follows. First, the BTM B is posited as the part of AUM that focuses on economic activities. Secondly, the interest of *Muhammadiyah* should be represented in the structure. This is achieved by assigning the management of PCM B to supervise

BTM B. Thirdly, as the owner, PCM B reserves the right to receive at least 20% of net income. By implementing this method, both BTM B and PCM B can run simultaneously. BTM B operates as AUM in providing financial services and generating income. At the same time, PCM B can continue spreading *dakwah* due to financial support from BTM B. Therefore, AUM had become the figurehead of *Muhammadiyah* in supporting its *dakwah* and social activities.

The philosophy of AUM services is highly influenced by its founder, Ahmad Dahlan, a *batik* merchant who set aside trading profits to finance the activities of *Muhammadiyah*. Accordingly, all productive activities to generate profit (*usaha*) should be juxtaposed with spreading dakwah (*amal*). This value has been instilled in the minds of *Muhammadiyah's* members and its activities, including AUM. The AUM has become the economic asset of *Muhammadiyah*. Despite having the dual dimensions of economic and social motives, the primary goal of AUM in accumulating profit (economic motive) is solely to support *Muhammadiyah's* activities (social motive).

AUM services have developed over the period and their activities mainly focus on three areas: education, health services and social activities. Starting from 1995, pioneered by BTM B, they have demonstrated their growth and potential as a source of funding to support *Muhammadiyah's* activities. BMTs throughout Indonesia have transformed and become an important AUM, as the chairman of the Economic Council and Entrepreneurship of the national office of *Muhammadiyah* states:

> *The economic power created by BTMs has transformed these institutions to become one of AUM's pillars in strengthening the support of dakwah and the social activities of Muhammadiyah at different levels. (ST04)*

9.4.2. Representing *Muhammadiyah* as a reformist movement

As discussed in Chapter 4, *Muhammadiyah* was established in a context where many Muslims in Indonesia were deemed to have deviated from the ideal practices of Islam and to be highly influenced by pre-Islamic traditions with elements of superstition. *Muhammadiyah* is determined to purify these practices by bringing the *ummah* (Islamic society) back to the original purity of the *Quran* and *Sunna*, as exemplified by the Prophet Muhammad (PBUH). Therefore, *Muhammadiyah* does not confine itself to any *Madh'hab* (Islamic schools of thought) that emerged and developed after the Prophet died. For this reason, *Muhammadiyah* is considered as a reformist movement.

> *Muhammadiyah has no affiliation to any Madh'hab; our religious practices are based on the Quran and Hadith. We practise the principle of 'ittiba' [literally meaning follow], which involves understanding the argument that underpins an opinion. (WR06)*

Despite declaring that they did not follow any *Madh'hab,* the opinions of the different schools of thought are used to comprehend the *Quran* and Sunna. If the doctrine of the *Madh'hab was* deemed not to comply with the *Quran* and Sunna, they avoided the doctrines.

> *In developing Islamic economics, Muhammadiyah has considered the economic concepts of the different madh'hab as a starting reference. We then referred to the main source of the Quran to identify the verses related to economic issues, and then we learnt the explanation and interpretation in the Hadith. We also involved the economists to get their opinions (ST04).*

In the context of IIMFIs, the reformist merits of *Muhammadiyah* are represented through a number of characteristics distinguishing BTM B and the majority of IIMFIs.

First, while the majority of IIMFIs named their institution *Baitul Maal wat Tamwil* (BMT), *Muhammadiyah* has a different opinion. Instead of incorporating the concepts of *Baitul Maal* and *Baitul Tamwil*, *Muhammadiyah* strictly segregates them. From *Muhammadiyah's* point of view, *Baitul Maal* is by nature a social institution, with the sources of funds being *zakah* (almsgiving), *infaq* (giving) and *sadaqah* (donation), while *Baitul Tamwil* is purely a business institution, with the sources of funds being mainly from capital investment and savings deposits. Therefore, *Muhammadiyah* took the position of adopting the term *Baitul Tamwil* and its financial institution became the *Baitul Tamwil Muhammadiyah* (BTM).

> *For Muhammadiyah, incorporating social matters (Baitul Maal) and business (Baitul Tamwil) into one entity does not comply with shari'ah principles because the zakah collection, management and distribution should follow the fiqh (Islamic jurisprudence) of zakah (WR01).*

On the other hand, the concept of *Baitul Maal* has been adopted by *Muhammadiyah* to facilitate the collection and distribution of *zakah* since 1918. In this area, the reformism of *Muhammadiyah* is reflected in being the pioneer in gradually transforming the practice of *zakah* from unmanaged and traditional individual giving to becoming organised (Fauzia, 2008). The collection and distribution of *zakah* became an annual and national movement of *Muhammadiyah* in 1940. The organisation of *zakah* has developed over the period and since 2001, the name *Baitul Maal* of Muhammadiyah has been changed to LAZISMU (*Lembaga Amal, Zakat, Infaq dan Shadaqah Muhammadiyah*), which exists in the different levels of *Muhammadiyah's* office (ST04).

Secondly, the separation of *Baitul Maal* and *Baitul Tamwil* enables BMT B to cover the potential losses from borrowers defaulting. This is because *Muhammadiyah* has a different opinion to *Nahdlatul Ulama* (NU) in terms of *zakah* utilisation. While the traditionalist NU follows the legal opinion that *zakah* should be disbursed to eight categories of beneficiaries (*ashnaf*), the reformist *Muhammadiyah* broadens the utilisation of *zakah* for other kinds of righteous activities, such as paying for operational costs of mosques and schools, establishing boarding schools, financing orphanages and empowering poor people. Therefore, if the borrowers of BTM B default, their debt is allowed to be covered by the *zakah* fund from the *Baitul Maal*/LAZISMU (WR03).

Thirdly, the unique characteristic that distinguishes BTM B from other IIMFIs or *Baitul Maal wat Tamwil* is the legal ownership. BTM B is owned by *Muhammadiyah* as an organisation, while other IIMFIs can be possessed by individuals, groups or organisations. With regard to ownership, the national office of *Muhammadiyah* established the strict regulation that any assets must be put into the name of *Muhammadiyah*. The asset can be possessed by different levels of offices: for example, BTM B is owned by the PCM B where BTM B operates.

Fourthly, while other IIMFIs have expanded their business by establishing branch offices in different regions, BTM B is not allowed to do so. Such a policy correlates with the philosophy of the establishment of AUM (including financial services), whereby AUM are intended to support *Muhammadiyah's dakwah* within which they operate.

> *A large number of big BMTs established branch offices everywhere under a single legal entity. On the other hand, every single BTM has its own legal entity. This is because BTM belongs to PCM and we are ethically not allowed to establish branches of BTM in other territories of PCM. (WR01)*

Finally, when other IIMFIs follow the *fatwa* (legal opinion) from the MUI (*Majelis Ulama Indonesia* – Council of Indonesian Ulama), BTM B adheres to the *fatwa* from the *Majelis Tarjih* (Council of Islamic Law) *Muhammadiyah*. The *Majelis Tarjih* was established in 1927 as an attempt to purify Islamic beliefs and practices in Indonesia. This institution has the responsibility of examining the different opinions of Muslim jurists on certain issues, to evaluate the faithfulness of those opinions based on the *Quran* and Hadith, and to issue *fatwa* with special attention to issues faced by the *ummah* in their daily lives. Therefore, the existence of *Majelis Tarjih* has been deemed to demonstrate the dynamic understanding of Islam within the Indonesian context. *Majelis Tarjih* maintains a hierarchical structure and is available at national, regional and district offices. The legal decisions made by the *Majelis Tarjih* at the national office bind the members of offices in the hierarchy below, but not vice versa. For this reason, *Muhammadiyah* does not follow the *fatwas* issued by the MUI, including *fatwas* on Islamic banking products.

As discussed briefly in Chapter 7, MUI is a legal institution that involves *muftis* (Islamic scholars who interpret Islamic laws) issuing various *fatwa* on different aspects of social life since 1975. With regard to Islamic financial institutions, MUI has an institutional body known as *Dewan Syariah Nasional* (National Shari'ah Committee), which was established in 1999 with the responsibility to produce *fatwa* regarding Islamic banking practices in Indonesia.

Rather than following the MUI's fatwas, BMT B adhered to the legal opinion of *Majelis Tarjih Pekalongan* when it started the *qard hasan*.

> *At the beginning of 1996, the concepts and product of Islamic banks were not known widely. When the Qard Hasan program started, the founders invoked Majelis Tarjih Pekalongan to evaluate Islamic economics and implementation in financial services. We referred to the Quran and Hadiths to seek Islamic products free from riba. Later, when a book titled 'Bank syariah: suatu pengenalan umum' (Shari'ah Banking: An Introduction) was published by Syafi'i Antonio in 1999, we used it as a reference to justify our practices (WR06).*

9.4.3. Upholding *Muhammadiyah* as their identity

Historically, *Muhammadiyah* has been associated with being a modernist movement among others represented by its organisational arrangement. Any entities operating under the name of *Muhammadiyah* should be attached to the hierarchy of the *Muhammadiyah* organisational structure. Therefore, despite being an autonomous and independent organisation, BTM B is inseparable from *Muhammadiyah*.

> *The difference between BMT and BTM B should be understood as a brand name that differentiates BTM B from other Islamic financial institutions. While others were established individually or by a group of people, BTM B is like a 'biological child' of Muhammadiyah as an institution (WR03).*
>
> *Muhammadiyah is attached to our institutional name; therefore we should uphold the reputation of Muhammadiyah. If other IIMFIs fail, they might not have encountered a big problem. However, when BTM B fails, as occurred in other sub-districts, the PCM B will take societal responsibility by providing explanations and compensation to its customers (WR01).*

As part of *Muhammadiyah*, BTM B always upholds the identity of *Muhammadiyah*. The interest of *Muhammadiyah* is in the forefront, and is reflected at both policy and operational level. At the policy level, PCM B bears the responsibility of controlling the operations of BTM B. Because the legal form of BTM B is cooperative and its members are individual, the control mechanism is achieved by appointing a number of PCM B's administrators to become ex officio members of BTM B. This means that the membership of the administrators will terminate automatically when their tenure finishes. As a member of BTM B, they also are entitled to obtain net income, but the profit is assigned to PCM B.

> *The representatives of PCM B are required to represent Muhammadiyah in the BTM B. They should be willing to 'mewakafkan haknya atas sisa hasil usaha' (devote their right over net income) because the PCM B has paid the membership contribution to the BTM B (WR02).*

The ex officio members consist of 70% of all members. They are dominant in determining policies such as the decision to increase the number of members in BTM B and the proportion of *qard hasan* (benevolent loan) in its funding structure.

> *We are committed to maintain the dominant proportions of membership in BTM B in order to ensure that BTM B does not only focus on profit making, but also upholds the mission of Muhammadiyah. If BTM B is owned by individuals, then empowering ummah will be quite impossible to achieve (WR03).*

The policy states that at least 5% of its funding should be allocated for *qard hasan*. This loan is intended to help poor people as well as support the mission of *Muhammadiyah* to spread the *dakwah* of *amar ma'ruf nahi munkar*. Therefore, it is distributed strictly for members of *pengajian* at *Muhammadiyah* mosques. The administrators of PCM B are actively involved in overseeing the distribution of loans. They provide references for new borrowers and act as peer support if someone finds difficulty in repaying the loan. If any defaults occur, they provide recommendations to *Baitul Maal Muhammadiyah* to cover the loan from the *zakah* fund and submit them to BTM B. At the staff level, upholding the identity of *Muhammadiyah* is conducted through the recruitment system and it continues after people become staff members. The requirement for applying for a staff position is that the applicant should be a member of *Muhammadiyah*, evidenced by the membership card. Such a policy aims to ensure that the applicants have an understanding of the value, vision and mission of *Muhammadiyah*. Furthermore, once they become a staff member, they are expected to be actively involved in assisting *dakwah.*

> *Our staff should not deem BTM B solely as a place of work. Instead, as a member of BTM B they should be an activator at the nearest Muhammadiyah office to where they live; at least they should attend the weekly pengajian (WR01).*

During *pengajian*, they are always reminded of the prominent message of Ahmad Dahlan, the founder of *Muhammadiyah*: '*hidup-hidupilah Muhammadiyah dan jangan mencari hidup di* Muhammadiyah' (keep reviving *Muhammadiyah* instead of seeking for life in *Muhammadiyah*). This message has been a moral principle of members to prevent them utilising *Muhammadiyah* for their personal interest. Since *Muhammadiyah* is a social and religious organisation, the members are also encouraged to *mewakafkan diri* (devote themselves) to *Muhammadiyah* in accordance with their capacity. They believe that such a form of submission will bring *risq* (prosperity and blessing) from Allah.

9.5. The *capital* of BTM B

In order to maintain or improve its relative position in the *field*, various forms of capital need to be exploited. The identification of *capital* accumulated and possessed by BTM B is as follows.

9.5.1. Economic capital

The *economic capital* of BTM B comprises different sources of capital and assets, as presented in the financial reports. Similar to other cooperatives, the main source of capital for BTM B is derived from its members, in the form of principal savings, compulsory savings and investments. Every member is required to contribute IDR 2 million[30] as principal saving and IDR 4 million (GBP 200) as compulsory saving. Both the principal and compulsory savings are paid once, so every member paid a total of IDR 6 million as initial capital. In order to generate more income through investment activities, members are allowed to contribute for investment purposes any amount in multiples of IDR 5 million. Due to limited access to data, this study only presents data based on the annual report of BTM B for the year ending 2011. The summary sources of capital for BTM B during 2010–11 are presented in Table 9-1.

Table 9-1 Sources of capital for BTM B in 2010–11 (in IDR)

Source of capital	2010	2011
Principal saving	200,000,000	200,000,000
Compulsory saving	400,000,000	400,000,000
Investment	44,500,000	0
Reserve	311,793,753.90	177,719,978.00
Total	956,293,753.90	777,719,978.00

Source: Annual report of BTM B 2011

From Table 9-1, it can be seen that the amount of principal and compulsory savings had been stagnant from 2010 to 2011. This was because no additional members were recruited during the years. By mid-2011, the number of members reached 100, consisting of 70 people as ex officio members and 30 as individual members. The decision to recruit a new member was based on the requirement for additional capital.

[30] About GBP 101, exchange rate then being 1 GBP = IDR 19,702 (1st May 2015)

The *economic capital* of BTM B had grown significantly. From the initial capital of IDR 25 million when it was first established in 1995, capital increased by more than double in 2000, reaching 52 million. This number continued to grow to more than 329 million and 938 million in 2005 and 2010, respectively. Trust in the society, as indicated by the amount of savings, also increased gradually, from only 32 million in 1995 to more than 12 million over the following 15 years. As a result, the amount of disbursements rose significantly, from 34 million in 1995 to 573 million in 2000. Then this amount was multiplied five times to more than 3 trillion during the next years. The *economic capital* indicator increased gradually from 1995 to 2000, except for distributed income, which went down by 42% from 278 million in 2005 to 161 million in 2010. This was because the board called for an increase in retained earnings to replenish capital (WR03). The growth of different types of *economic capital* in BTM B is illustrated in Table 9-2.

Table 9-2 Growth of economic capital of BTM B (in IDR '000) and its increase/decrease in percentage every 5 years

Year	Capital	Saving	Asset	Financing	Distributed net income
1995	25,000	32,716	64,760	34,931	308
2000	52,406 (+110%)	115,580 (+253%)	694,817 (+973%)	573,277 (+1541%)	58,744 (+18973%)
2005	329,327 (+528%)	4,014,658 (+3373%)	5,638,993 (+712%)	3,214,688 (+461%)	278,119 (+373%)
2010	938,814 (+185%)	12,567,188 (+213%)	14,805,553 (163%)	7,996,120 (+149%)	161,094 (-42%)

Source: BTM B

Moreover, the increase in the tangible assets of BTM B is obvious from the physical building from which it operates. It has moved from a small room to a modern building since 2005. The physical metamorphosis of BTM B can be seen in Figure 9-4.

Figure 9-4 The physical metamorphosis of BMT B from 1996 to the present

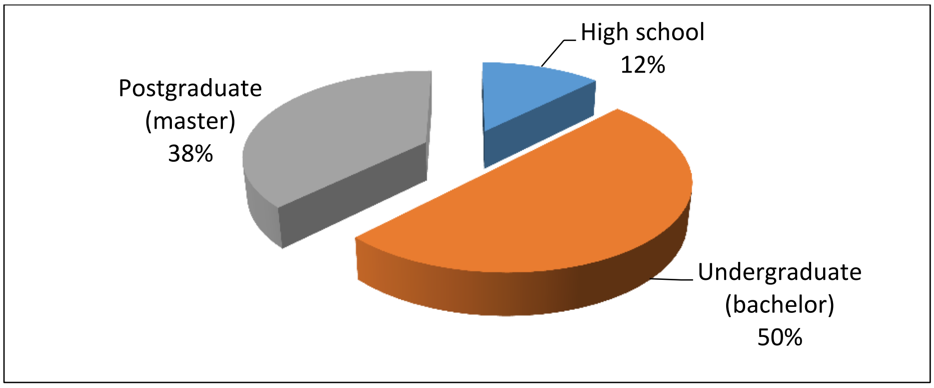
<table>
<tr><td></td><td>
</td></tr>
<tr><td>1996–1998</td><td>1998–2001</td></tr>
<tr><td>
</td><td></td></tr>
<tr><td>2001–2005</td><td>From 2005–present</td></tr>
</table>

Source: BTM B

9.5.2. Cultural capital

Cultural capital relates to the educational background, working experience, knowledge and skills of members of the board, management and staff. As discussed in Chapter 4 and as part of the organisational *habitus*, members of *Muhammadiyah* are predominantly well educated. In BTM B, the minimum level of education of the board and staff is senior/high school. Out of eight members of the board, only one graduated from high school, four hold a bachelor's degree and the remaining three people hold a master's degree. The level of education of board members is illustrated in Figure 9-5.

Figure 9-5 The education level of board members



Source: Author, data from BTM B

The chairman of the boards, who is also the founder of BTM B, has an educational background in Management at the Faculty of Economics, Indonesian Islamic University. He is currently a lecturer in Finance at the University of Pekalongan. He also has vast experience in establishing BPR (*Bank Perkreditan Rakyat* – People's Credit Bank) and BMT in Pekalongan. Hence, he plays a more dominant role in the organisation.

> *Despite establishing the division of tasks for the board members – chairman, vice-chairman, secretary, treasurer and support members – in reality, I was dominant in supervising BTM B because of my educational background and working experience in financial institutions (WR02).*

The chairman of the supervisory board holds a master's degree in Accounting and he is also a lecturer in Accounting at the Faculty of Economics of the University of Pekalongan. The main function of the supervisory board of BTM B is to act as an internal auditor to evaluate financial performance as well as to provide advice to the management and staff.

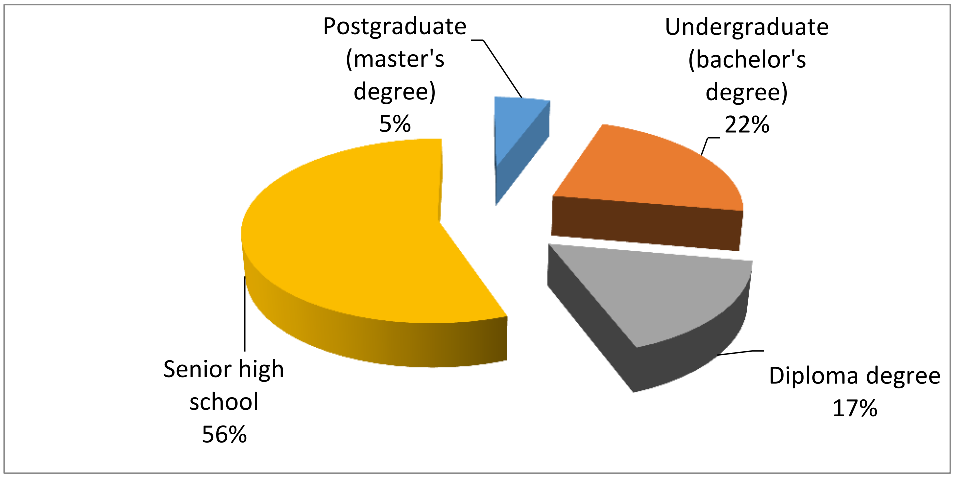
> *One of our functions as a supervisory board is to 'translate' the financial reports by explaining the meaning of the numbers presented in the financial reports to the majority of BTM's members who have no accounting/economic background (WR03).*

The *shari'ah* board member of BTM B is a teacher of *Ad-Diin* (Islamic religion) at the senior high school of *Muhammadiyah*. He is also a member of *Majelis Tarjih* of *Pengurus Daerah Muhammadiyah Pekalongan*, as discussed in the previous section. He explained the role of the *shari'ah* board in BTM B:

> *We perform tight supervision over the shari'ah practice in BTM B. We address complaints raised by customers and provide advice on problems encountered by members of staff regarding shari'ah compliance (WR06).*

The educational background of the management and staff of BTM B varies. The majority of staff graduated from senior high school, four staff hold a bachelor's degree in Management and the manager of BTM B holds a master's degree in Marketing. The manager, who is also one of the founders of BTM B, obtained his degree from the *Walisongo* Islamic State University. He worked for years in BPR (People's Credit Bank) prior to joining BTM B. The educational level of management and staff is illustrated in Figure 9-6.

Figure 9-6 The educational level of the management and staff of BTM B



Source: Author, data from BTM B

9.5.3. Social capital

Social capital refers to the relationship of the institution to other parties, such as their members, customers, the government, Islamic banks and the association. The main source of BTM B's *social capital* is the network of *Muhammadiyah* members. Supported by more than 30 million *warga* (members) of *Muhammadiyah* spread across the country, BTM B succeeded in creating a brand image of financial institutions owned by *Muhammadiyah*. Members of *Muhammadiyah* are encouraged to utilise the financial services provided by such institutions.

Moreover, as a pioneer, BTM B provided support to establish similar institutions in other places. Therefore, by mid-2012, such institutions had been established in a number of regions: 30 institutions are located in Central Java, 15 institutions in East Java and 28 institutions in Lampung (WR01, manager of BTM B). They have also become a strong network of BTM B to strengthen their position in the field of Islamic microfinance. Other forms of *social capital* owned by BTM B are *Muhammadiyah* entrepreneurs who require financial support. They are the ones who create the potential market for BTM B and boost its growth.

> *BTM B's operation seemed like fishing in the pond instead of in the high seas. The Muhammadiyah entrepreneurs are the main target market of BTM B. So it is not surprising that BTM B grew and spread very quickly (WR02).*

Other important social capital is the relationship of BTM B with the secondary cooperative of BTM Central Java. The secondary cooperative was established on the initiative of BTM B to overcome the collective problems encountered by its institutions. The secondary cooperative of BTM Central Java played a significant role in supervising, providing training and securing the liquidity of its members. For this reason, BTM B took the decision not to join any other associations related to IIMFIs.

> *The secondary cooperative of BTM Central Java took real actions in protecting its members by providing supervision and training. We also function as lender of last resort when they encounter difficulties in their liquidity (WR01).*

With regard to being involved in the associations of IIMFIs, the chairman of the *Majelis Ekonomi dan Kewirausahaan/MEK* (Economic and Entrepreneurial Council of *Muhammadiyah*) confirmed that the decision to become involved in the association of IIMFIs is at the authority of BTM B. Nevertheless, the Council deemed that the secondary cooperative of BTM Central Java has been an appropriate forum to accommodate the needs of BTMs in general (ST04).

The relationship of BTM B with other AUMs is also considered as a *social capital*. As discussed in Chapter 4, the AUMs provide various services related to education, health and orphanages. There are 13 AUMs in Pekalongan consisting of 10 educational institutions from primary school up to university, 1 health clinic and 2 orphanages. BTM B offers a savings program in a number of schools and BTM B's staff collect the deposits from students or teachers at the schools instead of them having to come to BTM B's office (WR04).

The *social capital* from BTM B's relationship with the government is relatively limited. It only relates to the obligation of BTM B as a cooperative to submit an annual report to the *Dinas Koperasi Kabupaten* (the cooperative office at the district level). As stipulated in the Cooperative Act, the *Dinas Koperasi* is supposed to supervise the cooperatives, including BTM B. However, the *Dinas Koperasi* does not function as stipulated by the Act. Therefore, although the cooperatives seem to be registered, they are not actually regulated (WR01). Moreover, BTM B also emphasised that it has never received any grants or funding from the government. It prefers to establish relationships with Islamic banks to deposit its excess funds and to get additional funds when needed to secure its liquidity.

> *We are pleased to establish a relationship with Islamic banks based on rational business reasons. From BTM B's side, they require additional money to fund the credits. On the other hand, Islamic banks, due to their limitation in reaching more people, need BTM B to channel their credits (WR01).*

9.5.4. Symbolic capital

Symbolic capital refers to recognition of the organisational achievement by external parties in the form of respect, reputation or prestige. The *symbolic capital* of BTM B is obtained inherently due to its attachment to *Muhammadiyah*. The reputation of *Muhammadiyah* as a reformist and modernist Islamic movement supported BTM B in accumulating its *symbolic capital*. Since trust is essential in financial institutions, the brand name of *Muhammadiyah* itself has gained societal trust, which reinforces the credibility of BTM B. If BTM B fails, *Muhammadiyah* as an organisation will take full responsibility to ensure that the problem will not harm customers, as exemplified by BTMs in other regions.

> *From many BTMs that have been established, only one failed due to mismanagement. The management of this BTM did not implement prudential practice when approving the loans. The high amount of credit was not backed up with appropriate collateral value. As a consequence, this BTM incurred a loss because the selling price of the collateral is less than their loan. This institution was forced to close. To preserve the reputation of Muhammadiyah, its PCM took the responsibility of returning all savings to the depositors (WR02).*

The success story of BTM B in developing financial services as well as supporting *dakwah* has been acknowledged as a breakthrough in financing the activities of *Muhammadiyah*. Therefore, *Muhammadiyah* in other places are interested in establishing similar institutions in their region. In this process, BTM B has been a source of reference to provide advice and technical support. Moreover, the MEK at the national office has recognised that, pioneered by BTM B, financial services operating under the name of *Muhammadiyah* have been one of the most important economic pillars of *Muhammadiyah*. In the long term, this financial institution is expected to grow and is prepared to buy back the shares of *Muhammadiyah* in *Bank Bukopin Syariah* (ST04).

The willingness of a number of BMTs (*Baitul Maal wat Tamwil*) in Central Java to transform their institutions into *Baitul Tamwil Muhammadiyah* is considered as *symbolic capital*. This was because of the performance of the pilot project of BTM B that demonstrated its significant growth. Moreover, they also deemed that the leadership of BMT B in the secondary cooperative of BTM Central Java had brought benefits for their members. Acting as the secondary cooperative, the manager and chairman of the boards of BTM B had designed a mechanism to support their members through ensuring their liquidity and providing adequate supervision.

9.6. Accountability and governance practices within BTM B

As discussed in Chapter Two, the practice of accountability focuses on the day-to-day operations and any activities related to receipt and distribution of loans, record keeping of transactions, and preparation of financial reports.

Moreover, governance practices encompass both conformance and performance aspects, with the former relating to the adherence to laws and regulations, including *shari'ah*, while the latter focuses on strategies, policies and organisational structure. Therefore, the discussion on governance in this study concerns the activities conducted by the management team and the board. This includes a number of activities, such as:

- Establishing a strategic plan and programs for organisational development and achievement of the organisation's mission and vision;
- Setting the organisational structure and job descriptions;
- Recruiting staff members;
- Establishing policies for salary or net-income distribution;
- Preparing budgets and monitoring the achievement of or deviance from budgets;
- Ensuring *shari'ah* governance;
- Establishing cooperation with external parties (the government, the Islamic banks, other IIMFIs and other institutions) based on mutual benefits;
- Discharging accountability to members through organising the AGM;

9.7. The development of accountability and governance *practices*

According to Bourdieu, *practice* is influenced by *capital* and *habitus* within the *field*. Changes in *capital* and those imbued by *habitus* will cause changes in *practice*. The transformation of BTM B, including the growth in *capital* and its *practices*, will be discussed based on three distinct phases: establishment of the *Baitul Maal*, transformation to *Baitul Tamwil* and replication of BTM B in other places.

The interrelationships between the different types of *capital*, *field* and *habitus* and the *practice* of accountability and governance within BTM B over the three phases will be explained.

9.7.1. Phase 1: Establishing the *Qard Hasan* program

As described earlier, the idea of empowering economic *ummah* through small-loan programs started when a member of *Muhammadiyah* who lived in Jakarta made a *waqf fund* commitment of IDR 25 million. As a native of the sub-district where BTM B is located, he was interested in PCM B's program to mobilise funds to finance its activities. Therefore, he submitted a donation to PCM B with the intention for it to be utilised as a revolving fund. The chairman of PCM B called on WR01 and WR02, who were the initiators of PCM B's previous mobilising program, to come up with a model for utilisation of the *waqf* fund. Due to the nature and characteristics of *waqf*, which should be used for a specific objective as determined by the donor, they decided to manage the fund separately from the mobilising program. They developed a mechanism to distribute the fund through a *qard hasan* (virtuous loan), where the borrowers need to repay the loan with the same amount as they borrowed. This proposal was approved by the PCM B and the program started at the beginning of January 1996.

In order to administer the program, PCM B hired two staff who had graduated from the vocational school and had knowledge of bookkeeping. The two staff were members of *pengajian Aisyiyah* (Muhammadiyah's women's organisation) and they were interviewed and recruited by WR02. Prior to administering this program, the two staff undertook an apprenticeship for two weeks in BMT *Bahtera* Pekalongan, where WR02 worked. The training aimed to introduce the administration process of recording transactions. Therefore, they could adopt a similar process when they administered the *qard hasan* program.

To run the program, a small empty room at one of the *Muhammadiyah* primary schools was used as the operational office, equipped with only two desks and several chairs. The staff's duties were to keep a record of the names of borrowers, the amount of their weekly instalments and the amount of savings. Since both of them had a background in bookkeeping, they were directed by the founders to create a logbook for each borrower and a passbook if they needed one to save their money.

> *From the sheets of paper, we made a kind of 'logbook and passbook' for each borrower with the PCM B's logo on the front of the book. We recorded their payments and savings manually in those books (WR08).*

The *qard hasan* was introduced and distributed through *pengajian* in the mosques of the *Muhammadiyah* sub-branch office (PRM). The amount of the loan was standardised at IDR 52,000 per member and they were required to make instalment payments of IDR 2,000 every week for 26 weeks or 6 months. They were not allowed to borrow again until their *qard hasan* had been paid completely. The loan was limited only to the members of *pengajian*. The management of PRM reviewed the eligibility of the members of *pengajian* based on their economic condition and their commitment to attend *pengajian*. Through the *pengajian*, besides making the IDR 2,000 weekly loan instalment, they were encouraged to make savings if they had an excess of funds. The savings functioned as a reserve fund in case they found difficulties in making the instalment or as an investment that could be withdrawn whenever they needed it.

The *waqf fund* of IDR 25 million was distributed entirely through the 22 PRMs. There were more than 400 members who became the first batch of recipients of the loans. The management of PRM also assigned one of the members to act as the coordinator for loan payments. The duty of the coordinator was to record the members who received the loans, and to receive and record the loan instalments as well as the savings at the end of *pengajian*. For the loan instalment, she created numbered columns showing the names of borrowers and the number of instalments (1–26 weeks). When the borrowers paid the loan, she put a tick against their name and the appropriate week. She had a separate list to record the savings made by the borrowers. Every Friday, the coordinator went to the *qard hasan*'s office to submit the money received, along with the records of loans and savings.

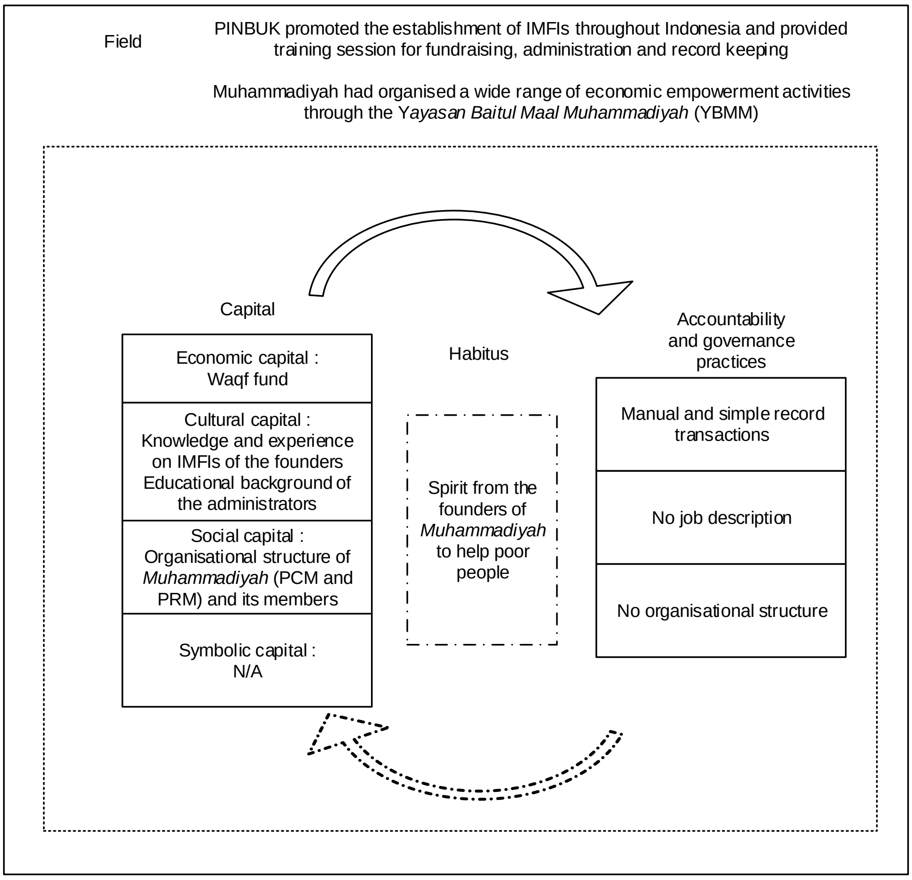
The *qard hasan*'s office only opened three days a week: Thursday, Friday and Saturday. They updated the passbooks and logbooks on Thursday for about 400 borrowers, then received the payments from the 22 collectors of PRM on Friday and prepared the summary of transactions on Saturday. They also prepared a weekly report to the chairman of PCM B and WR02. The program went smoothly and no delinquency was reported. Moreover, all the loans were paid back in less than the scheduled 26 weeks, so the loan money could be distributed to more and more members.

From 1995–97, the *field* of Islamic microfinance institutions was dynamic. PINBUK made massive efforts to spread the establishment of BMT (*Baitul Maal wat Tamwil*) throughout Indonesia as an attempt to meet the demand for Islamic financial services in rural areas. As discussed briefly in Chapter 7, PINBUK was established in 1995 by the ICMI, an organisation of Indonesian intellectual Muslims that was dominated by Muslims from the *Nahdlatul Ulama*. On the other hand, the *Muhammadiyah* social movement had not specified the development of Islamic financial institutions.

Muhammadiyah had organised a wide range of activities in empowering the economics of *ummah* through the *Yayasan Baitul Maal Muhammadiyah* (YBMM – the foundation of *Muhammadiyah's Baitul Maal*) that exists in the national office. As discussed in the *habitus* section, the concept of *Baitul Maal* has been adopted by *Muhammadiyah* since 1918, but the institution's name has changed many times, including the YBMM. Later, in the context of IIMFs, the YBMM played an important role in providing legal protection for Islamic financial institutions operating under the name of *Muhammadiyah*.

To summarise, the *qard hasan* program started with a minimum of economic capital from the *waqf* fund of IDR 25 million. Despite the limited economic capital, the program was supported by strong social capital from the hierarchical structure of *Muhammadiyah* of the PCM B, PRM and their members. The PCM B provided a space for the operational office and paid the salaries of the administrators, while the PRM empowered economic and spiritual *warga Muhammadiyah* through the *pengajian* and *qard hasan* program in the mosques. Moreover, this program was also supported by *cultural capital* in terms of knowledge and experience in Islamic MFIs by the founders (WR01 and WR02) and the educational background in bookkeeping of the two administration staff. Based on the spirit of the founders of *Muhammadiyah* to help poor people, the program went well and more and more people could utilise the loan. This was because it was administered in an orderly and modest way. The identification of the different kinds of *capital*, *habitus*, *field* and *practice* of accountability and governance during the first phase is illustrated in Figure 9-7.

Figure 9-7 The *capital, habitus, field* and accountability and governance *practices* during the *Qard Hasan* program



Source: Author

The *qard hasan* program ran successfully and all the loans were paid back with no delinquency recorded. However, the initiators of the program considered that it had not brought benefits to the Muhammadiyah as an institution. Moreover, the sustainability of the program was questionable because the borrowers paid back the same amount as they borrowed. The operational costs for salaries and administration were paid by the PCM B. Therefore, the initiators decided to develop this program into a business.

9.7.2. Phase 2: Transforming into a *Baitul Tamwil* and cooperative

The success of the *qard hasan* program indicated by the increasing demand for micro-loans inspired the founders to develop this program into a business. Since both the founders have an educational background and experience in financial services, they developed this new institution to resemble BPRS (*Bank Perkreditan Rakyat Syariah* – Islamic People's Credit Bank). Moreover, based on their understanding that *Baitul Maal* should focus on social activities while *Baitul Tamwil* is purely for business, they decided to name the new institution *Baitul Tamwil Muhammadiyah* (BTM). It is followed by the region name where they operate, so the full name of the institution is BTM B.

In order to legitimise their operations, BTM B sought a kind of operating licence from the YBMM at the national office. Following the hierarchical structure of *Muhammadiyah*, the YBMM was deemed as the institution that has authority to provide legal protection for BTM B. Finally, the YBMM issued the legal status of BTM B as a participant in the *Proyek Hubungan Bank dan Kelompok Swadaya Masyarakat* (PHBK – Project Linking Bank and Self-Help Groups). Therefore, BTM B was legally enabled to mobilise and distribute funds from the society. PHBK is discussed briefly in Chapter 7.

Utilising the initial *waqf* fund of IDR 25 million as capital, BTM B diverted the virtuous loan product of *qard hasan* into two Islamic business products: *musyarakah* (partnership) and *mudharabah* (profit sharing). The borrowers who are members of *Muhamamdiyah* were encouraged to deposit their money in BTM B in order to increase its capital. The economic capital of BTM B and the number of borrowers increased gradually through the savings and financial products.

> *We continued to administer the remaining qard hasan loans. For those who had paid back their loans and intended to re-borrow, we offered them other products as we were no longer providing the qard hasan (WR08).*

The two members of staff hired in the first phase were not able to cope with the workload. Therefore, the chairman of PCM B decided to hire one administrative staff member plus a manager. There was still no organisational structure and only a division of tasks among them. However, the task divisions were not rigid, as they shared their duties in administering the service and preparing reports for the manager. The main task of the manager was to establish a strategy to broaden the customer base, to supervise the staff and to report the operational performance of BTM B to the chairman of PCM B as the owner. The operations of BTM B went well and the fund increased gradually from IDR 25 million to IDR 34 million within three months. After three months, the chairman of PCM B received a report from staff on their suspicion that the manager was using the fund for his personal interest. After investigating the case and detecting the fault, ultimately the chairman of PCM B decided to terminate the manager’s employment.

> *Due to lack of supervision from the PCM B, the manager arbitrarily used the fund for his personal interest (WR01).*

Following the dismissal of the manager, the chairman of PCM B held a meeting to which he invited the founders of WR01 and WR02. The meeting discussed the prospects and sustainability of the operations of BTM B in the future. The essence of the meeting was to assign WR01 and WR02 to manage BTM B.

> *The chairman of PCM B conveyed that they had provided full support for the establishment of BTM B. However, learning from the recent incident, they hesitated to give permission for BTM B to continue its operations, unless both WR1 and WR02 were willing to manage it (WR 01).*

If both the founders refused to accept this duty, PCM B would close BTM B, considering that the asset size was relatively small and PCM B only had to return deposits to customers, which amounted to about IDR 9 million. As a manifestation of their obedience to *Muhammadiyah*, WR01 agreed to accept responsibility as the new manager of BTM B and WR02 as the supervisor from June 1996.

With new management, BTM B received exceptional support from PCM B. The operational office was moved to a house owned by a member of PCM B because the previous office in the school building was being refurbished. The chairman of PCM B visited BTM B weekly to ensure that the institution ran smoothly. The management and chairman of PCM B transferred their money from their previous banks to BTM B to increase its operational fund. PCM B encouraged the big merchants and businessmen of *Muhammadiyah* members to deposit their money in BTM B. Another member of *Muhammadiyah* from Semarang in Central Java donated a computer and printer to support the administration. Since a new manager had experience in Islamic MFIs, he broadened the range of products. As a result, the number of customers increased significantly and the assets grew from IDR 34 million to 125 million within a year. BTM B also managed to cover its main operational costs, salaries and administration costs.

In terms of governance practices, the manager of BTM B was strictly monitored by the supervisor. Both of them reported the achievement of their operation to PCM B on a monthly basis. The standard operational procedure (SOP) for the transactions was prepared to standardise practices in delivering financial services. Moreover, in ensuring the *shari'ah* compliance of the operation, a member of the management of PCM B who is also a member of *Majelis Tarjih Muhammadiyah Pekalongan* was invited to evaluate the operations from the *shari'ah* perspective.

In terms of recording transactions, the new management changed the manual recording process to computer based. The manager invited a programr to create a computer program for administering the transactions as well as preparing financial reports. BTM B continued to grow and to accommodate the rapid growth in size, a number of new staff were hired and the operational office moved to a new building (see Figure 9-4) in 2005.

BTM B also developed new services and products classified into three categories: products related to mobilising funds, and those related to the disbursement of funds and services. BTM B adopted the prudential principle in its operations by establishing standard operating procedures, minimising the risks of financing and increasing supervision. Moreover, in realising the social mission in supporting the *dakwah* of *Muhammadiyah* and in empowering *ummah*, BTM B allocated 5% of its financing for *qard hasan*. This product was distributed through *pengajian* in mosques as discussed previously and limited only to their members.

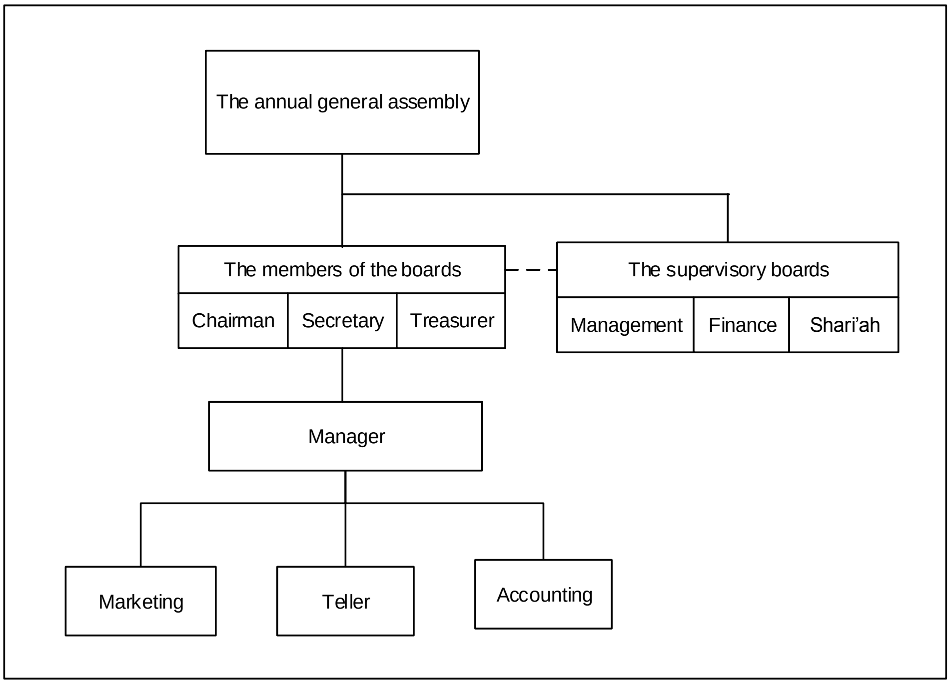
In 1999, there was a significant change in the *field* of Islamic microfinance. By the enactment of Act No. 29/1999 concerning Indonesia's Central Bank, the PHBK program was abolished. The abolition automatically voided the legality of the operation of IIMFIs, including BTM B. At the national level, PINBUK encouraged IIMFIs throughout Indonesia to transform their legal status into cooperatives or BPR (People's Credit Bank), as discussed in Chapter 7. Since BTM B was under the supervision of YBMM, BTM B was not allowed to decide its own option; instead, it was ordered by the national office. Eventually, the *Muktamar* (national meeting) of *Muhammadiyah* in 2000 recommended that all BTMs were allowed to decide their legal status either as cooperatives or BPRs. The majority of them decided to opt for a cooperative as their legal status, including BTM B.

Following the *Muktamar*'s recommendation, PCM B's meeting in August 2001 decided to transform the legal status of BTM B to a cooperative. Therefore, BTM B adjusted its organisational structure to conform to the rules as stipulated in the Cooperative Act. After considering the strengths and weaknesses of cooperatives, WR01 and WR02 designed a number of steps for the transformation process. First, since a cooperative is an association of people, the members of the cooperative must be individuals and the decision was based on one man, one vote. From the perspective of *Muhammadiyah* as the owner of BTM, this arrangement had the potential to dilute the voice and interest of *Muhammadiyah*. Therefore, the membership of BTM B was divided into two categories: individual members and ex officio members as representatives of *Muhammadiyah*. The composition of ex officio members was established to be at least 51%. The individual members would be selected and approved by PCM B. This was to preserve the ownership of *Muhammadiyah* and to align the goal of BTM B and that of *Muhammadiyah*.

Secondly, the chairman of PCM B acts as chair of the advisory board. The board members and the supervisory board members were selected by the PCM B. Thirdly, the accumulated capital, which had reached IDR 100 million, was converted into principal and compulsory savings, as stipulated by the Cooperative Act. Since the Act sets the minimum number of members to establish a cooperative at 20, PCM B appointed 20 people as ex officio members. By doing this, the BTM B cooperative is still 100% owned by *Muhammadiyah*. Therefore, PCM B as the owner is entitled to receive at least 20% of BTM B’s net income. Fourthly, BTM B is not allowed to possess fixed assets such as land and buildings. All the fixed assets are owned by PCM B and BTM B can only lease fixed assets from PCM B.

Once PCM B completed this arrangement, the manager of BTM B registered the institution with the *Dinas Koperasi Kabupaten* (the Cooperative Office at the district level) and received the Decree of the Ministry of Indonesian Cooperatives in September 2001. Based on the provisions in the Cooperative Act, the organisational structure of BTM B was established as illustrated in Figure 9-8.

Figure 9-8 The organisational structure of BTM B



Source: BTM B

The new organisational structure includes job descriptions stating in detail the tasks expected, the line of authority, functions and the basic requirements (educational background, experience, skills) for a particular position. However, from the perspective of the founders, the organisational structure of the cooperative was inappropriate for a microfinance institution. This is because the Act assigns an organisational structure consisting of the board (chairman, vice-chairman, secretary and treasurer) and the supervisory board.

> *This structure was ineffective because it is not based on organisational needs, instead it is to fulfil the regulations. As a result, people were selected not because of their competence, but only to fill those positions (WR02).*

To amend the Cooperative Act, the Indonesian Ministry of Cooperatives issued Decree No. 91/Kep/M.KUM/IX/2004 concerning the operational guidelines for Islamic financial cooperatives. The Decree required the IIMFIs to establish a *shari'ah* supervisory board to ensure *shari'ah* compliance. To fulfil this requirement, the chairman of PCM B assigned one of its members, who was also a member of *Majelis Tarjih*, as chair of the supervisory board. The monitoring of *shari'ah* compliance was performed by observing the operations of BTM B or addressing complaints from customers. The monitoring mechanism was also conducted by external parties, such as members of *pengajian*. When the *shari'ah* board detected or found a practice to be non *shari'ah* compliant, the supervisory board member clarified the position to the manager of BTM B and provided suggestions on how to improve the practice. When BTM B developed new products, it had to consult the *shari'ah* board prior to offering this product to society.

> *I ceased the new savings product issued by BTM in other sub-districts last year because it promised fixed gains not based on ratios (WR06).*

The members of the board and the supervisory board hold regular meetings every three months to discuss a number of issues related to BTM B, such as the evaluation of financial performance, problems encountered and complaints from customers. The supervisory board acts as an internal auditor and will evaluate the liquidity and measure the health of the organisation using a number of financial ratios such as loan growth, deposit growth, loan/deposit ratio, efficiency ratio, capital ratio and return on equity/return on asset and credit quality.

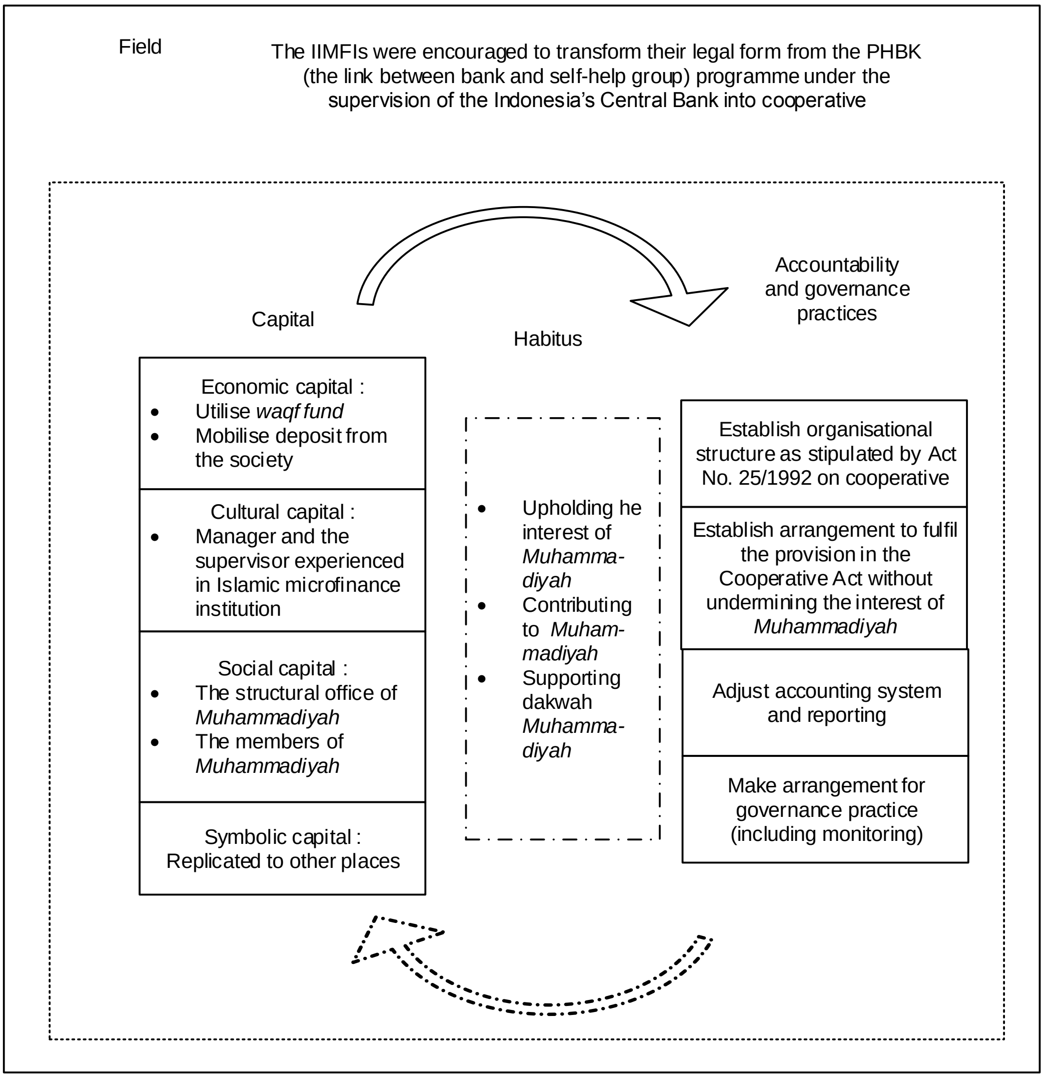
In terms of the accounting system and reporting, a number of adjustments were made. This was done by inviting the programr to adjust the application program in order to fulfil the regulations as stipulated in the Cooperative Act. Recently, BTM B's financial reports were audited by the external auditor and they received an ‘unqualified opinion’. Moreover, BTM B also discharges its accountability to its members through an annual general assembly that is usually held at the end of January or the beginning of February. During the assembly, the members of the board present BTM B’s achievements through the financial report, while the supervisory board reports the evaluation of management performance, management process and *shari’ah* compliance. The report was printed in a book, *Laporan kegiatan usaha, rencana kegiatan usaha dan laporan badan pengawas* (activity report, business planning and supervisory report).

> *During the annual general assembly, there were a number of questions and inputs from the members to improve the performance of BTM B in the future (WR03).*

To summarise, BTM B moved to the second phase of organisational growth by shifting its orientation from being purely socially motivated to being business motivated. Despite operating with limited economic capital, BTM B obtained incredible support from its *social capital*, primarily from the management of PCM B and *warga* (members) of *Muhammadiyah*. Supported by knowledgeable, skilful and trusted (*cultural capital*) staff and management, BTM B experienced gradual growth. However, there was a change in the field of Islamic microfinance, causing it to transform its legal status to a cooperative following the recommendation of the national office of *Muhammadiyah*.

To abide by the provisions as stipulated in the Cooperative Act, BTM B made adjustments on a number of aspects, such as membership composition and the election process. This was made to preserve the interest and voice of *Muhammadiyah* as the owner of BTM B. The change in the legal status brought significant changes in the practices of accountability and governance. The identification of capital, field, habitus and practices of accountability and governance in the second phase is illustrated in Figure 9-9.

Figure 9-9 The identification of *capital*, *habitus*, *field* and accountability and governance *practices* during the second phase of BTM B



Source: Author

9.7.3. Phase 3: Establishing the secondary cooperative of BTM

As discussed in the previous section, the success story of BTM B in creating a source of funds to support the *dakwah* of *Muhammadiyah* as well as empowering the *ummah* had attracted PCMs in various regions to establish BTMs in their areas. BTM B had been a reference for the establishment of BTM in other places.

> *When BTM B had demonstrated its growth, there was increasing interest in studying the Islamic microfinance model at BTM B. The national office of Muhammadiyah had recommended external parties to learn the practice of Islamic microfinance here (WR01).*

In its development, other BTMs in Pekalongan also sought the assistance of BTM B when they encountered problems. The growth and increased number of BTMs required some form of coordination to assist and provide support when they faced problems. In anticipating this development in the future, the founders of BTM B initiated the establishment of a kind of association or forum of BTMs whereby they could share experiences and provide peer support. Since the legal status of BTMs is cooperative, the forum complies with the Cooperative Act.

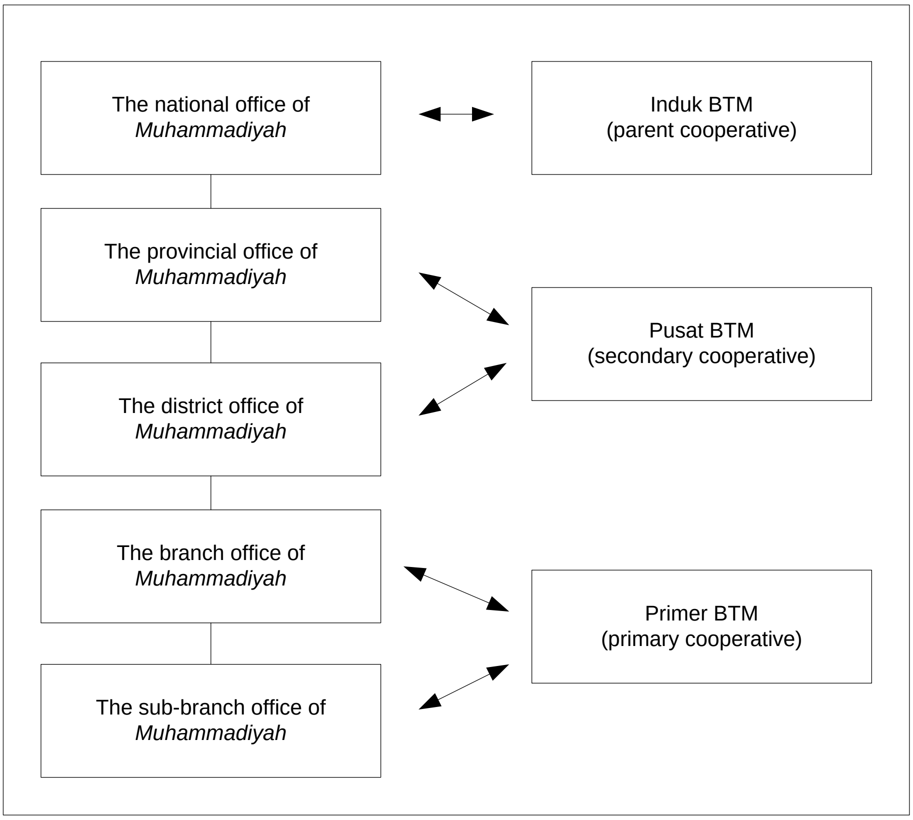
> *When developing the BTM forum, we evaluated the most appropriate form for the forum. Since the legal status of BTMs is cooperative, we decided to use the hierarchical structure of a cooperative, i.e. the secondary cooperative (WR01).*

According to the Cooperative Act, the hierarchical structure of a cooperative is as follows: a primary cooperative in which the members are individuals, and a secondary cooperative in which the members are the primary cooperatives and the parent cooperative. The founders of BTM B designed the development of BTMs by adopting such a hierarchy and linking them to the *Muhammadiyah* structure. In this structure, the *induk* BTM (parent cooperative) is the national office of

Muhammadiyah, the *pusat* BTM (secondary cooperative) can exist at either the provincial level or district level of *Muhammadiyah*, and the *primer* BTM (primary cooperative) can be owned by the branch or sub-branch office of *Muhammadiyah*.

While the primary cooperative provided financial services directly to customers, the secondary cooperative functioned as the liquidity controller, supervisor and training provider for its members. The establishment of the national network (*induk*) of BTMs is to enhance collaboration among BTMs throughout Indonesia, to increase the bargaining position of BTMs and to broaden the opportunity to cooperate with external parties (the government or banks). The structure is illustrated in Figure 9-10.

Figure 9-10 The hierarchical structure of BTM cooperatives



Source: BTM B

To realise this concept, BTM B invited four BTMs near Pekalongan and they agreed to establish a secondary cooperative, called the *Pusat* BTM of Central Java. After this development, BTM B moved to the third phase of organisational growth.

The *Pusat* BTM Central Java obtained its operating licence from the Indonesian Ministry of Cooperatives in March 2003. Since its establishment, the operational office of *Pusat* BTM has been attached to the BTM B office. The *economic capital* or source of funds was derived from the members' contributions in the form of principal and compulsory savings. When it started in 2003, the initial capital was only IDR 351 million. The *economic capital* in terms of equity, assets, the amount of financing and the net income gradually increased following the increase in social capital in terms of the number of BTMs that joined *Pusat* BTM Central Java. The growth of economic capital and social capital of *Pusat* BTM are illustrated in Table 9-3.

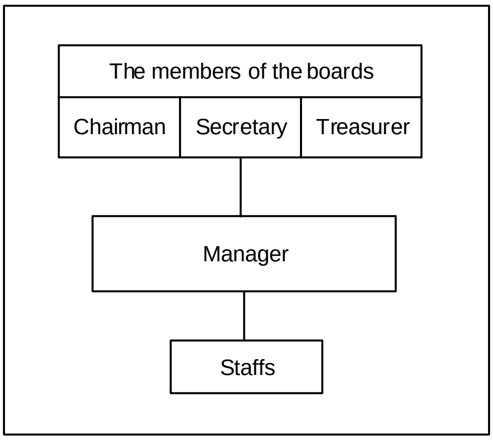
Table 9-3 The growth of economic capital and social capital of the *Pusat* BTM, 2003–09

Year	Number of members	(in IDR million)			
		Equity	Assets	Amount of financing	Net income
2003	8	351	396	174	19
2004	9	486	686	155	45
2005	9	655	813	428	45
2006	10	697	1,118	456	32
2007	10	907	4,583	3,282	121
2008	12	1,144	5,901	4,415	168
2009	13	1,259	5,691	4,778	51

Source: BTM B

In terms of *cultural capital*, the founders of *Pusat* BTM had been practitioners in Islamic MFIs for years and they hold degrees in Economics, Management or Accounting. In order to administer the operation of the secondary cooperative, a simple organisational structure was established, as illustrated in Figure 9-11. The chairman of the boards and the manager of BTM B hold the same position at the *Pusat* BTM.

Figure 9-11 The organisational structure of the *Pusat* BTM



Source: BTM B

Driven by similar interests to develop their BTMs in supporting the *dakwah* activities of Muhammadiyah, the *Pusat* BTM implemented a number of practices to realise the functions of the secondary cooperative, as follows.

First, the *Pusat* BTM functions as the controller of the liquidity of members or as the lender of last resort. The main problem encountered by microfinance institutions was liquidity or the capability of institutions to fulfil their near-term obligations, such as withdrawals by depositors. In general, microfinance institutions were susceptible to liquidity problems that are seasonal, for instance during the month of Ramadhan, Eid Fitr and the beginning of the school term. Since *Pusat* BTM has access to financial sources from Islamic banks, it is able to channel funds from the Islamic banks to its members. The benefit of this system for its members is the simplistic nature of the process, as the BTMs propose the amount they need to the *Pusat* BTM and sign the *uqud* (contract) without having to provide collateral.

Secondly, *Pusat* BTM functions as a monitoring institution. Its members are required to send in their financial reports monthly. The reports are analysed to evaluate their financial health, to identify problems and to provide some recommendations. Every six months, an evaluation meeting is held and attended by all members, including the board of directors and the supervisory board. The chairman of *Pusat* BTM will present the evaluation report of its members, identify any problems and deliver some suggestions to improve their performance.

> *At the beginning, it was hard to introduce the evaluation practice as it is deemed to be insulting, especially in front of their colleagues. But this is the way we could learn from each other's experiences. In this forum, the board of directors of each BTM could evaluate the performance of their BTM as well (WR01).*

Thirdly, *Pusat* BTM functions as the training centre for members of the boards, the supervisory board, management and staff. The aim was to improve their skills and knowledge in providing financial services in order to accommodate the changes in customers' demands. The training also included a wide range of self-development activities such as motivation, achievement, personality assessment and working as a group. The training was scheduled regularly, at least once a year for the management and staff, while for the boards and the supervisory boards training was held every two years. In conducting such training, *Pusat* BTM established collaboration with external consultants in Islamic business training and the Islamic banks. The training is funded by the individual BTMs from the reserves from the net capital income they generate annually.

Being members of the secondary cooperative improved their performance because *Pusat* BTM took real actions in securing their liquidity, evaluating their performance as well as providing business training for their members. This achievement attracted other Islamic financial institutions to join *Pusat* BTM, including the BMT (*Baitul Maal wat Tamwil*). To fulfil the principal requirement that membership of Pusat BTM should be in the form of a BTM, a number of BMTs voluntarily converted themselves to BTMs. Since the BTM was designed to be owned by *Muhammadiyah*, the conversion process had to follow a number of steps, as discussed in the previous section when BTM B transformed its legal status to cooperative. As a result, members of the *Pusat* BTM increased gradually from 8 BTMs in 2003, to 13 BTMs in 2009 and 23 BTMs in 2013. The increase in the number of members was followed by an increase in the economic capital in the form of assets, equity and the net income of *Pusat* BTM.

Almost at the same time as BTM B initiated the establishment of the secondary cooperative of BTMs, there was an attempt to establish associations of BMTs (ABSINDO and BMT Centre) in the *field* of Islamic microfinance institutions. The aim of ABSINDO and BMT Centre was to function as a self-regulating body for their members and to improve the bargaining power of BMTs. From the beginning, all BTMs took a stand not to join the association. However, sharing of information on recent developments in IIMFIs in Indonesia has been done informally between the chairman of ABSINDO and the chairman of the MEK Muhammadiyah.

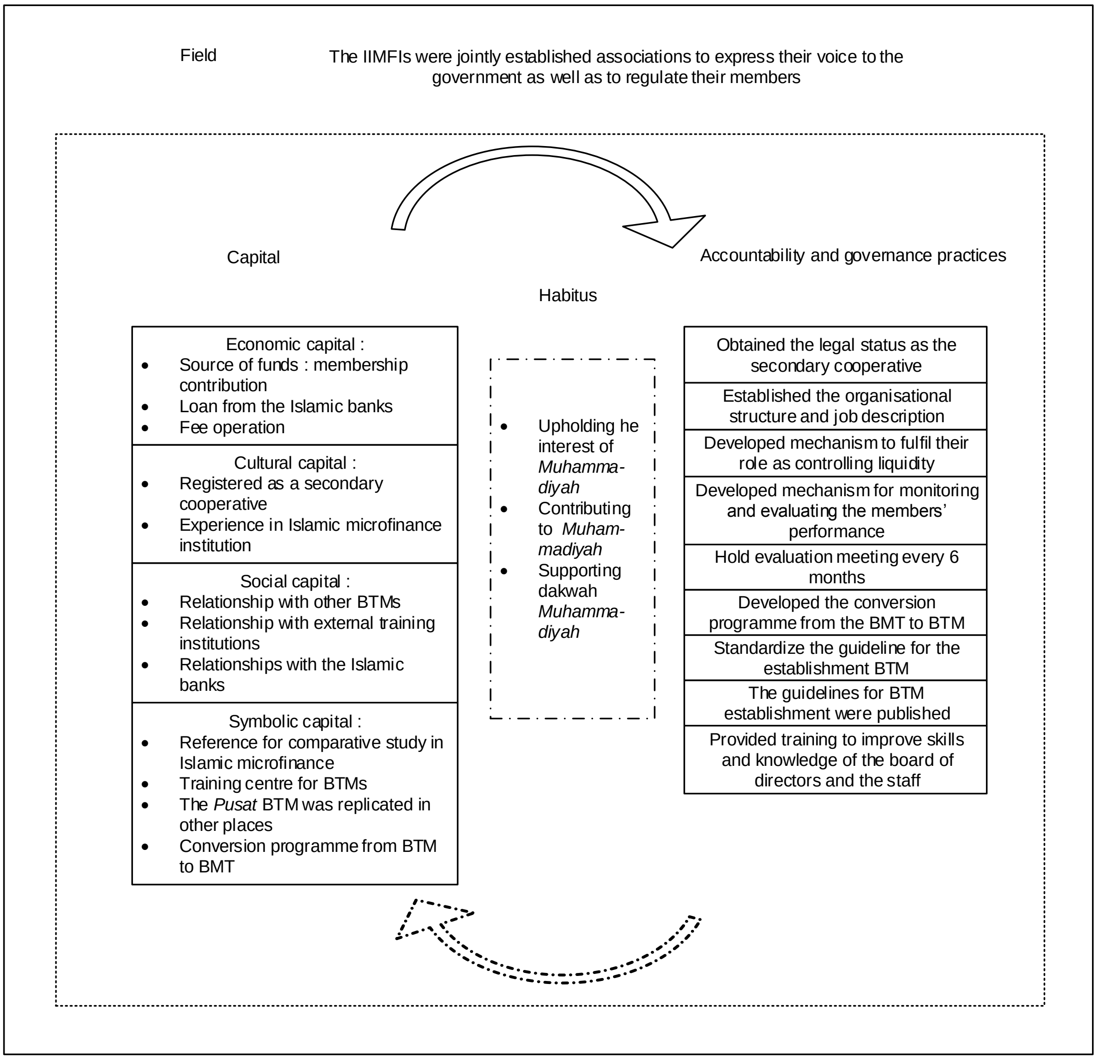
> *The chairman of ABSINDO is the vice-chairman of the Majelis Ekonomi Muhammadiyah (MEK – Economic and Entrepreneurship Council) and he was one of the best cadres of Muhammadiyah. We shared information related to a number of issues that might affect the development of Islamic microfinance in Indonesia (ST04).*

In anticipating the growth and development of BTMs, *Pusat* BTM standardised the establishment process of BTMs through a book entitled *Panduan dan Pedoman Pendirian BTM* (Guidelines for the Establishment of BTMs). This book explains the foundation of BTMs, including the concept, the historical background, the legal status, and the function, mission and vision of BTMs. This book also provides detailed guidelines on the steps for establishing a BTM, the stages for converting a BMT to a BTM, the governance practice of BTMs, the different types of BTM products and the process for obtaining the legal status of BTM.

In attempting to disseminate the guidelines throughout Indonesia, a book was proposed to the *Muhammadiyah* at the national level to obtain approval from the *Majelis Ekonomi dan Kewirausahaan* (MEK – Economic and Entrepreneur Council). This is because in the *Muhammadiyah* structure, regulations established by the higher-level *Muhammadiyah* office will bind the lower-level offices. In 2012, this book was published and was used as guidelines for establishing BTMs in Indonesia. The success story of *Pusat* BTM of Central Java in improving the performance of its members was followed by the establishment of *Pusat* BTMs in East Java and Lampung provinces. There was no information about the number of their members. Until the beginning of 2013, the *induk* BTM at the national office has not yet been established due to lack of human resources. Accordingly, there was relatively no coordination among *Pusat* BTMs in Central Java, East Java and Lampung.

To summarise, BTM B moved into the third phase of organisational growth, which involves the establishment of the secondary cooperative of BTMs, called *Pusat* BTM Central Java. Supported by exceptional forms of economic, cultural, social and symbolic capital from the internal sources of *Muhammadiyah* and other parties, *Pusat* BTM developed a number of governance and accountability *practices*. *Pusat* BTM was designed as the communication forum for BTMs and it had three main functions: as liquidity controller, supervisor and training provider. This concept was in line with the movement in the *field* of Islamic microfinance institutions to establish ABSINDO and BMT Centre as a self-regulatory institution for BMTs in Indonesia. The identification of capital, habitus, field and accountability and governance practices is illustrated in Figure 9-12.

Figure 9-12 The identification of *capital, habitus, field* and accountability and governance *practices* of *Pusat* BTM



Source: Author

9.8. Summary and conclusions

This chapter has discussed the empirical findings from the second case selected on IIMFIs in Indonesia. Guided by Bourdieu's theory of practice, where *practices* are informed by various types of *capital* and *habitus* in the particular social arena, the first section of this chapter identified the organisational *habitus*. The organisational *habitus* of BTM B developed when the founders and staff were actively involved in the organisation of *Muhammadiyah*. The values and philosophies of the *Muhammadiyah*'s movement have shaped the moral disposition or habitus of BTM B. This was manifested in their perception of BMTs as one of the vital pillars in supporting the *dakwah* activities of *Muhammadiyah*. The prominent characteristics of *Muhammadiyah* as a modernist and reformist movement resulted in the different characteristics of BTM B compare to BMTs, including accountability and governance *practices*. While BMTs combine the institutions of *Baitul Maal* and *Baitul Tamwil*, BTM B is strictly separate and adopted the concept of *Baitul Tamwil*. As a *Baitul Tamwil* that focuses on business, the accountability mechanism is designed to demonstrate the capability to manage assets (PCM B). While a BMT can be owned by individuals or groups, the owner of BMT B is strictly the organisation (*Muhammadiyah*). Accordingly, in terms of governance, BTM B is controlled and supervised by the owner to protect its interest.

This chapter demonstrated that accountability and governance practices had developed over time. They were informed by changes in the organisation of various kinds of capital and imbued by the *habitus*. The growth of BTM B has evolved in three phases: initiating the micro-loan program of the *Baitul Maal*, transforming the *Baitul Maal* to *Baitul Tamwil* and then converting the legal status to a cooperative, and establishing the secondary cooperative of BTM. In the first phase, BTM B started with the concept of *Baitul Maal* that mainly focused on the social mission to provide a *qard hasan* (virtuous loan) for the poor group of *Muhammadiyah* members. There was no administrative requirement for applying the *qard hasan*, and the recipients were selected by the management of PCM B. The administrative staff created a simple logbook for each loan to record payments from the borrowers. This program was a success and the demand for loans increased gradually. Borrowers were required to pay back the same amount as they borrowed. However, the sustainability of this program was questioned as the loan does not generate any income to cover operational costs. Moreover, the *Muhammadiyah* as the owner of this program has not received any benefits.

So the initiator of this program decided to transform the institution to *Baitul Tamwil*, which is more business oriented. Having experience in financial services, the founders designed the *Baitul Tamwil Muhammadiyah* (BTM), which is similar to the *Bank Perkreditan Rakyat* (BPR). The accounting system, reporting and governance practices that have been implemented are similar to the practices in the commercial banks. During its development, there was a change in the regulations requiring BTM B to transform its legal status to cooperative. The transformation process was not easy, because the cooperative, which is member based, was deemed to undermine the interest of *Muhammadiyah*. Therefore, the founders of BTM B designed a number of provisions in the transformation in order to align the goal of BTM B in accordance with the goal of *Muhammadiyah*. Once the transformation was completed, the organisational structure, governance and accountability *practices* were adjusted to comply with the provisions of the cooperative.

BTM B continued to grow and contributed significantly to supporting PCM B's activities. Its success story attracted other PCMs to establish similar BTMs in their areas. As a result, a number of BTMs were established. Driven by the similar problems they encountered in their operations, BTM B invited BTMs around Pekalongan to establish the secondary cooperative named *Pusat* BTM, which is intended to be a communication forum to support each other. From this point, BTM B moved to the third phase of its growth. The *Pusat* BTM had three main functions: liquidity control, supervision and training provision. In discharging its functions, the *Pusat* BTM developed accountability and governance *practices* that help in improving the performance of its members significantly. The accountability mechanism is designed to monitor, to evaluate and to provide suggestions to improve the financial performance of its members. The governance mechanism was designed to provide adequate supervision for its members, but still to allow flexibility in managing the institution.

In short, BTM B has transformed its orientation from a non-profit loan program to a business-oriented organisation and become one of the important economic pillars of *Muhammadiyah*. To summarise, the identification of the capital and habitus of BTM B that have affected its accountability practices during the three phases of its growth is presented in Figure 9-13.

Figure 9-13 The *capital*, *habitus* and accountability and governance *practices* of BTM B during the three phases of its growth

Field
(Discussed in chapter 7)

Age of organization

Bourdieu's concept \ Organisational growth		Phase 1 Creativity	Phase 2 Direction	Phase 3 Coordination
		Started micro-loan programme of the *Qard Hasan*	Transformed to *Baitul Maal and cooperative*	Established the secondary cooperative of BTM
Capital	Economic	Source of funds only from the *waqf fund*	Start to mobilise funds/ collect savings	Source of funds was varied
Capital	Cultural	The initiators had a background in Islamic MFIs	The experience in managing Islamic financial services	Have experience in managing Islamic microfinance
Capital	Social	The structural office of *Muhammadiyah* and its members	The structural office of *Muhammadiyah* and its members	Widen the networks with external parties
Capital	Symbolic	N/A	The concept of BTM was replicated in other places	Become the centre of reference
Habitus		The values and philosophies of *Muhammadiyah* as a reformist and modernist movement		
Accountability and governance practices		• Manual and simple record keeping • Accountability focus on financials, conducted to the PCM • No organizational structure	• Transformed the organisational structure according to the Cooperative Act • Adjusted the organisational arrangement to align the structure of cooperative with the interest of *Muhammadiyah*	• Established the organisational structure • Developed mechanism for evaluation of performance • Standardise the process of BTM establishment

External challenges

- The regulations are obscure
- No supervision from the government
- Business competition

Source : Author

PART V

CHAPTER 10 DISCUSSION AND CONCLUSIONS

10.1. Introduction

This chapter aims to provide a summary and to conclude and reflect on the findings of this study. Section 10.2 summarises the findings related to research objective 1, which aims to examine the historical development of the Islamic microfinance sector in Indonesia. Understanding how the *field* of Islamic microfinance emerged and developed in Indonesia will help to understand why the accountability and governance *practices* in selected IIMFIs have developed over the period. This is because the changes in the regulatory framework within the *field* of Islamic microfinance as narrated in Chapter 7, as well as the changes in *capital* and *habitus* have affected the practices of accountability and governance of the two cases of IIMFIs selected in this study, as presented in Chapters 8 and 9. It also provided insight that the development of the *field* of Islamic microfinance in Indonesia has resulted in IIMFIs that have the same goals to ensure their sustainable operation in the long term, but with different *modus operandi*.

Section 10.3 presents a summary of findings that correspond to research objective 2, which aims to investigate how accountability and governance mechanisms are constructed, developed and practised in the two selected cases. In brief, the accountability and governance *practices* within organisations are dynamic rather than static. The development of accountability and governance *practices* within an organisation is affected by the growth of different types of *capital*, the organisational *habitus* and also changes in the field of Islamic microfinance.

The findings of this study have important implications for the development of the IIMFI sector in Indonesia. Therefore, this study also suggests recommendations for further development. Both the implications and the recommendations of this study will be discussed in Section 10.4. Finally, Section 10.5 offers a reflection in terms of the limitations of this study and suggestions for further research.

10.2. The historical development of the Islamic microfinance sector in Indonesia

This study utilises the theory of practice proposed by Bourdieu (1992). The concepts of *field*, *capital* and *habitus* that affect the *practices* of accountability and governance were taken together to guide in explaining how accountability and governance *practices* were produced and reproduced within the two selected cases of IIMFIs. Since the historical and cultural context affects the practices of accountability and governance that institutions adopt (Haniffa & Cooke, 2002; Tricker, 2009a), understanding the context within which the organisation operates is essential. In this sense, the concept of *field* helps in analysing such a context through examining the historical development and contemporary movements of the Islamic microfinance sector, as well as analysing the social configuration within which the *field* is embedded (Emirbayer & Johson, 2008). The Islamic microfinance sector in Indonesia is dynamic: it has developed and changed following shifts in the socio-economic and political situation in Indonesia. Therefore, understanding the development of and changes within this sector will help in comprehending how the accountability and governance *practices* of IIMFIs have changed and developed over a period of time.

In investigating the *field*, Bourdieu suggests the identification of four aspects: the genesis of the *field*, the position of the *field* in relation to other *fields*, the specific struggle of the *field* and the contemporary movement within the *field* (Kay & Laberge, 2002). Following this suggestion, this study has reviewed the literature on the history of microcredit initiatives in Indonesia and the country's socio-economic and political situation during the last five decades. These findings were confirmed through interviews. Accordingly, this study has identified a number of important milestones in the *field* of Islamic microfinance. Based on the fundamental changes in this *field*, the discussion on the historical development of the Islamic microfinance sector in Chapter 7 is divided into four major periods: the Dutch period, post 1980–1990, post 1990–2000 and post 2000.

The history of microfinance initiatives in the first two periods does not affect the accountability and governance *practices* of the two cases in this study. However, those periods are important to discuss, since the root of financial services based on Islamic teaching can be traced back to this time.

The first period covers Dutch colonisation. It started when the headman in the district of Purwokerto, Central Java, R. Aria Wiraatmadja (Steinwand, 2001), took the initiative to collect social funds from the mosque to help poor people nearby (this was called *Baitul Maal*). This initiative is considered as the embryo of Islamic microfinance in Indonesia. The *Baitul Maal* grew exceptionally well and it was formalised as a banking institution in 1895. This institution was named *De Purwokertosche Hulp-en Spaarbank der Inlandsche Hoofden* and it transformed itself into interest-based lending. After Indonesia's independence, the institution was nationalised and its name changed to Bank Rakyat Indonesia in 1946. The second initiative of establishing a kind of Islamic micro-credit was the establishment of a *lumbung desa* (village barn), for which the initial capital was to come from a *zakah* fund. This institution was established by the support of the Dutch colonial officer in Purwokerto, De Wolff, with the aim of helping farmers during the famine. The *lumbung desa* grew significantly and it became established throughout the country. However, due to a shortage of funds and fraud, the institution was forced to close in 1934. After this period, Islamic micro-credit vanished from Indonesia.

The second period was marked by the awakening of an Islamic movement in Indonesia that paved the way for the development of Islamic financial institutions, including IIMFIs. The Islamic awakening movement that began in the 1980s was influenced by the revolution in Iran that aimed to restore Islam as a way of life. The triumph of the Iranian revolution inspired young intellectual Muslims from the Technology Institute of Bandung to take similar action in spreading Islam. They organised a series of Islamic activities in mosques, including the attempt to implement *shari'ah* in business through establishing the *Baitul Tamwil* Teknosa. A number of students from other universities in Java undertook training on the implementation of *shari'ah* in business and, years later, they established IIMFIs in their hometowns. There is no documentation on the history of *Teknosa* and why it disappeared. However, *Teknosa* is considered the first model of an Islamic microfinance institution in Indonesia.

The socio-economic and political situation in Indonesia during the third and fourth periods had affected the Islamic microfinance sector in the country. Accordingly, the changes in the field also influenced changes in the accountability and governance *practices* of selected IIMFIs in this study.

Within the third period of 1990–2000, a number of milestones in Islamic financial institutions and microfinance have been identified. Firstly, the establishment of the first Islamic Bank in Indonesia helped to promote the dissemination of a profit-sharing system in financial services institutions, including IIMFIs. Secondly, the establishment of PINBUK (the centre for incubation of small business) played a significant role in providing basic training for the establishment of IIMFIs, including recording of transactions and bookkeeping. Therefore, accountability practice in terms of preparing financial reports followed the template as exemplified by PINBUK. Moreover, in terms of governance, IIMFIs operated under the programme of the Indonesian Central Bank. Thirdly, the enactment of Law No. 23/1999 concerning the Central Bank abolished the linked programme between the Indonesian Central Bank and IIMFIs. Consequently, IIMFIs had to forfeit their legal status, which undermined their operational legitimacy. A number of IIMFIs were forced to close due to the accusation of illegal practices. From this point, the Islamic microfinance sector moved into the next period.

The post-2000 period was marked by a gradual transformation of the legal status of IIMFIs to cooperatives, following the abolishment of the linked programme of the Indonesian Central Bank. This transformation required IIFMIs to comply with Act No. 25/1992 concerning cooperatives. This transformation substantially changed the ways in which IIMFIs were directed and controlled; that is, their governance. This was the result of the shift in ownership, and also the organisational as well as capital structure. The changes in accountability and governance practices at the meso or organisational levels can be explained using the concepts of *capital* and *habitus*.

10.3. The impact of capital and habitus on the (re)construction of accountability and governance practices in the two cases of IIMFIs

Accountability and governance practices are socially and continually constructed (Sinclair, 1995; Yakel, 2001) and their construction is influenced by beliefs, social norms and values (Skelcher, Mathur & Smith, 2005; Rhodes, 2007). The findings in this study, as discussed in Chapters 8 and 9, have demonstrated that the growth of different types of *capital*, imbued by the *habitus* that forms part of the organisational culture (Goddard, 2004), had caused accountability and governance practices to change. Moreover, the development of different *practices* was found to correspond with the different stages of organisational growth, as suggested by Smith et al. (1985).

Both the institutions studied have evolved through three different stages, from small experimental projects to being among the biggest and most influential IIMFIs in Indonesia. In the first stage, both the IIMFIs started as micro-loan pilot projects, although driven by different motivations. In the case of BMT A, the motivation to initiate the project was driven by the intention to fight for *riba* (usury), while the motive of BTM B was to develop a source of funding to support the activities of *Muhammadiyah*. When the founders started these projects, both of them utilised the limited capital they have, especially economic capital. The focus of their activities was merely to run the programme effectively. Their strong belief that the funds they managed were a form of trust (*amanah*) and that they would be accountable to Allah in the hereafter compelled them to pay more attention to 'felt accountability' instead of formalised accountability and governance practices. This was achieved in the following ways. Firstly, they hired staff who are deemed trustworthy ('who is accountable') to administer the programmes on a daily basis with minimum supervision. Secondly, 'the discharge of accountability' was done through recording transactions manually to identify and trace the flow of funds. Thirdly, staff prepared and presented reports to the founders of the loan programme, as the party 'to whom account is to be rendered'. Finally, the 'aim of accountability' in the first stage was mainly focused on ensuring that the funds were fairly distributed to the right people and that clients could pay them back. This was achieved through reminding clients of their debt obligations in Islamic teachings.

In terms of governance practices, there was no formal organisational structure or job descriptions. The founders themselves played significant roles as both trustees and operational directors in supervising and directing the staff to ensure that the programmes ran well. They implemented the framework of Islamic governance through the mechanism of mutual consultation (*shura*), whereby all decisions were made based on *musyawarah* (consultation, deliberation or discussion) among founders and staff.

Despite adopting modest accountability and governance *practices*, both institutions succeeded in accumulating different types of *capital* as they gradually grew. Accordingly, the existing accountability and governance *practices* needed to be changed to accommodate such growth. At the *field* level, the regulatory changes had affected the Islamic microfinance sector and required IIMFIs to transform their legal status to cooperatives. At this juncture, both BMT A and BTM B moved into the second stage of organisational growth.

In the second stage, both institutions started to adopt business-like practices. This requirement was driven by two factors: internal and external. The growth of *capital* requires organisations to change their organisational arrangements, including accountability and governance *practices*, while external change in regulation forced the institutions to transform their legal status to become a cooperative or limited company. Both BMT A and BTM B decided to transform into cooperatives, but the transformation processes were different. Since its establishment, the legal status of BMT A has been cooperative. However, it does not fulfil the provisions of being cooperative as stipulated in Act No. 25/1992 concerning cooperatives. As BMT A has been a member-based organisation, the transformation process was relatively simple. BMT A is required to set up an organisational structure as specified in the Cooperative Act. Accordingly, it suggested that the founders occupy various positions in the structure. On the other hand, the transformation process within BTM B was much more complicated. This is because the owner of BTM B is *Muhammadiyah* as an institution, not individuals as stipulated in the Cooperative Act. Therefore, the founders had to adjust the ownership structure, capital structure and organisational structure to comply with the Cooperative Act.

The transformation of BMT A and BTM B into cooperatives brought the implication of change in their accountability and governance *practices*. As discussed in Chapter

2, a cooperative is classified as a social enterprise (SE) with the primary objective of promoting social well-being. Accordingly, any surpluses generated from these activities are reinvested for business purposes or for the community. The accountability mechanism within a social enterprise is explained as follows. Firstly, the accountor (who is accountable) is the organisation that is represented by the board of directors and the supervisory board. This is because within a democratic organisation such as a cooperative, the boards were elected by organisational members. Therefore, the boards bear the responsibility for discharging their accountability to the members. Secondly, organisational members become the accountee (to whom account is to be rendered). Thirdly, the mechanism to discharge accountability to members is conducted through annual general assembly as the highest forum of accountability in the cooperative. During these annual assembly, the boards are required to report their performance by presenting financial reports. They are also required to explain the business plans, budgets and strategies to achieve their goals. In this forum, the board's performance is evaluated by the members. The reward for the board's achievement is that the board will be re-elected by the members. Finally, the accountability *practices* that have developed during the second stage of organisational growth are intended to achieve a number of objectives: accountability for compliance, accountability for resources, accountability for performance and accountability to the *ummah* (society).

In terms of governance, both BMT A and BTM B adopted the democratic governance model, whereby the election process to select the boards is based on the principle of one man, one vote. The function of the boards is to represent the interest of their members. Therefore, to maintain the interest of *Muhammadiyah* for BTM B and the interest of PPS for BMT A, both BMT A and BTM B established requirements for membership. In particular, BTM B restricted the number of members. Moreover, it also maintained the composition of two types of membership: 70% of ex officio members and 30% individual members. In terms of Islamic governance mechanisms, both BMT A and BTM B started to establish *shari'ah* supervisory boards to ensure that the practices the institutions adopted comply with *shari'ah* principles. Both also maintained the concept of *shura* (mutual consultation) in their decision-making processes.

Within both institutions, significant changes in accountability and governance practices occurred during the second phase. There was no fundamental change in such practices during the third phase, although they succeeded in accumulating massive capital. However, due to a dissimilar habitus between BMT A and BTM B, both organisations grew and flourished in different ways. BMT A expanded its Islamic propagation (*dakwah*) to fight for *riba* through business by establishing a number of branches under the supervision and control of BMT A. It also established BMT AA to accommodate the development of branches outside the East Java region. As a result, the organisational structure of BMT A and BMT AA expanded, corresponding to the increase in the number of branches. It adopted a centralised organisational structure, hence requiring some adjustments in its accountability and governance practices, such as dividing the organisational structure between head office and branch office, delegating the supervisory function from the boards to a representative committee, replacing a manual recording system by a computerised one, as explained detail in Chapter 8.

On the other hand, BTM B encouraged the *Muhammadiyah* offices in other regions to replicate the institution in their areas. This is because BTM B has demonstrated its success in developing financial services to support the *Muhammadiyah dakwah* in the region where BTM B operates. Later, with the support and assistance of BTM B, a number of BTMs were established in Pekalongan and other districts. Despite operating under the same name of BTM (to distinguish such institutions, the name of BTM is followed by the region name), such institutions are actually independent of each other and owned by the local *Muhammadiyah* office. In their development, the BMTs encounter similar problems, primarily a liquidity problem due to a shortage of funds. To overcome such collective problems, BTM B initiated the establishment of a secondary cooperative of BTMs that functions as peer support and a self-regulatory institution for its members. The organisational structure for the secondary cooperative is designed as a decentralised organisation. Within this structure, the authority for operational decisions is under the control of the individual BTM, while the head office retains the responsibility as liquidity controller, supervisor and training provider. Therefore, this requires the standardisation of operating procedures in accountability and governance mechanisms, as explained in Chapter 9.

Despite developing different accountability and governance practices, both BMT A and BTM B share similarities in their accountability elements, as follows. There was no difference between 'who is accountable' and 'to whom account is to be rendered' from the second stage to the third stage. This was because there was no change in terms of their legal status. However, in terms of 'how accountability is practised', the accountability mechanisms developed were more sophisticated. They implemented the prudential approach and their performances were evaluated based on financial performance measurements similar to those employed in banking institutions. Overall, the accountability practices in both BMT A and BTM B were developed not only for the purpose of fulfilling the requirements of compliance, procedure, resource utilisation and discharge of accountability to *ummah*, but were also intended to ensure their continuity; that is, the sustainability of the operation in the long term.

10.4. Implications of the study and recommendations

Informed by the theoretical framework discussed in Section 5.6, this study demonstrated that the construction of accountability and governance practices within IIMFIs was established through the external and internal system. The socio-economic and political situation as an external system has informed the *field* of Islamic microfinance sector. In turn, based on Bourdieu's theory of practice, the changes within the *field*, together with organisational history also influence the establishment of accountability and governance practices of selected IIMFIs.

The findings of this study have successfully filled the gaps in term of literature, methodology and theory adopted as discussed in Section 3.5. This research broadens the scope of studies on accountability and governance by examining the historical perspective of the establishment and development such practices. Furthermore, adopting Bourdieu's theory of practice within an Islamic context illuminates how religious values and beliefs shape the accountability and governance practices.

This study found that IIMFIs, including the two selected cases, have grown exceptionally, starting from small institutions with limited assets, then flourishing and developing into big and significant IIMFIs. Due to the lack of supervision from the authorised bodies, they developed their own accountability and governance practices to help them in ensuring their sustainability to continue their operations in the long term. The accountability and governance practices within different types of organisation as discussed on Chapter 2 section 2.2.5. have not fully explained the accountability and governance practiced by the selected IIMFIs in this study. While the root of accountability and governance from conventional perspective arose from the principal-agent problem and material aspect which is measured in a monetary form; the Islamic perspective of accountability and governance derives from the Muslim's obligation to Allah that leads to the implicit contract with Allah as well as an explicit contract to human beings both individually and in society. Moreover, accountability also encompasses both good and bad deeds during a person's life on earth and life hereafter as illustrated in Figure 2.4. As a consequence, the business within IFIs involves complex transaction and should comply with *shari'ah* principles. Therefore, it requires strong internal control through the principle of consultation (*shura*), religious audit and *shari'ah* supervisory board.

While the current approach seems to serve their purpose well, as they have more independence in deciding on the trajectory of their organisations, especially as they are founded in Islamic teachings, the current complacency on the part of government in terms of providing appropriate support, regulations and supervision for IIMFIs may have a number of important implications for the sector.

First, the growth of IIMFIs has been exceptional in terms of both numbers and assets. Such institutions have demonstrated the important role they play in empowering poor people to become more economically independent. However, a number of IIMFIs have been reported to have closed or to be technically bankrupt due to internal mismanagement. Such closures can lead to the domino effect, when depositors rush to withdraw their money from healthy institutions due to the loss of societal trust in such organisations. If many depositors withdraw at the same time, such institutions will run short of liquidity. Accordingly, even healthy institutions will be forced to close because they fail to fulfil their obligations to their depositors. To avoid such an event happening, the government should therefore make an effort to prevent these failures by providing adequate monitoring and supervision mechanisms. Given that the size in terms of assets varies and the number of IIMFIs is currently estimated to be more than 3,000, the government needs to classify IIMFIs into three categories: small, medium and large. This classification may facilitate determination of the level of monitoring and supervision required. In the case of small IIMFIs, since the amount of their assets, the scope of their business and the number of their clients are limited, they should be encouraged to grow and develop innovations to improve their performance and be given more independence. On the other hand, the government needs to pay more attention to the supervision of medium and large IIMFIs, because their failure or closure would have a widespread impact on depositors, borrowers and ultimately societal trust in this alternative form of micro-financing.

Secondly, the findings indicate that IIMFIs suffer from ineffective supervision from the authorised body. Act No. 25/1999, the Cooperative Act, required IIMFIs to register as cooperatives with the Ministry of Cooperatives (MoC) through the provincial or district cooperative authorities. Consequently, they are obliged to send their annual financial reports to the authorities. However, IIMFIs were found never to have received feedback or evaluation of their performance from the MoC.

Interviews with staff from the MoC confirmed that despite the Ministry having formal supervisory power as stipulated in the Act, its human resources are limited and incapable of performing the supervisory tasks. Moreover, the majority of staff in the cooperative authorities at the provincial or district level have no educational background in accounting or experience in auditing to perform important supervisory roles. Considering this limitation, the MoC should appoint consultants or independent auditors to assist them in evaluating the performance of IIMFIs in the future.

Thirdly, this study reveals that out of the four elements of the Islamic perspective of governance mechanisms – that is, *shura* (consultation), *shari'ah* supervisory board (SSB), *hisba* institution and *shari'ah* audit – only the first two elements were widely adopted by the IIMFIs. For both the selected IIMFIs, *shura* or *musyawarah* (discussion) to achieve *mufakat* (consensus) has been their tradition in the decision-making process and this has been implemented from generation to generation. Moreover, to comply with the regulations, the SSB was established with its main duty to guide the operations of IIMFIs in accordance with the principles of *shari'ah*. However, the other two pillars – namely, *hisba* institutions and the *shari'ah* audit – have not been implemented in Indonesia. The *hisba* institution or a kind of office of the Ombudsman has the responsibility to make sure that Islamic business entities uphold business ethics and maintain quality standards (Doragawa, 2013). In the context of Islamic financial institutions, the *hisba* plays a significant role as an inspector to monitor and evaluate the performance of the SSB. The assurance of *shari'ah* compliance can thus be achieved through the internal governance mechanism of the SSB and the external governance mechanism of the *hisba*. In this case, the government should make an effort to establish the *hisba* institution for the purposes of monitoring and ensuring the *shari'ah* compliance of Islamic financial institutions, including IIMFIs.

Moreover, the existence of the *shari'ah* audit is also important, because the contemporary financial audit is deemed inadequate to take into account the *shari'ah* aspects. Therefore, the needs of *shari'ah* assurance for stakeholders cannot be fulfilled (Haniffa, 2010). However, interviews with the auditor of BMT A revealed that the implementation of *shari'ah* audit in Indonesia is impossible, as the *shari'ah* audit standard has not yet been established. In this case, the government, through the MoC, should facilitate a number of parties, such as the Indonesian Accounting Association, the Indonesian Institute of Public Accountants, the Association of IIMFIs and the Islamic Ulema Council, to work together in preparing standards for the *shari'ah* audit.

With respect to internal control mechanisms, this study found that the internal control of both BMT A and BTM B is rather weak. This is because the division of tasks between the boards and management is rather blurred. Despite there being documented evidence of job descriptions, standard operating procedures and standard operating management, the practices do not strictly adhere to the documents. In BMT A, the boards and the management share the duties of directing, monitoring and controlling the entities. This may be attributed to the closeness and commitments to each other that have developed over the long term, from their school time up to the present. In BTM B, since the boards are only present during the quarterly meeting, then for the sake of practicality the board delegates a part of its functions to the management. This includes the responsibility for authorising transactions, preparing reports for the annual general meeting and formulating business strategy.

Moreover, despite holding *musyawarah* (discussion), the management in both BMT A and BTM B is very dominant. The boards could not perform their function effectively because of a lack of competency, as the majority of them have no academic background and experience in business. In both the selected IIMFIs, competency was found to be possessed by only the managers and the chairmen of the boards. Therefore, the boards function as a 'rubber stamp' of the management's decisions (Kosnik, 1987). In this circumstance, the function of supervising and evaluating management could not be performed effectively. In other words, the management performance has never been truly evaluated. This suggests that in the future, since the role of the boards is crucial, they need to upgrade their knowledge, skills and competency in order to perform their functions effectively.

Both the IIMFIs selected also demonstrated that the turnover of the boards and management is relatively low. Since their transformation into a cooperative, the people in management positions and the chairmen of the board have never changed. The chairman of the board has been elected during successive annual general assembly, and there have only been slight changes and rotations of members of the boards. Up to the present time, the board has appointed the same person to manage the daily operations. From the interviews, the members of the board state that their organisational charter has not provided a provision to restrict the tenure of board members or the director. Thus, they can be elected as board members as long as the members still trust and choose them.

The low level of rotation of the board brings two implications. On the one hand, the performance of the boards can be improved because they have been accustomed to the same organisational practices. One study revealed that rotation or change in the board can cause inefficiency, because the knowledge and experience of the departing board members are sometimes difficult to replace (Cruz & Romero-Merino, 2006). On the other hand, the low level of turnover can indicate that there is no regeneration, and this stagnant situation can undermine the potential of new and young members to develop and bring innovations to the institution. In both BMT A and BTM B, the founders are still actively involved and they are dominant in operational decision making and in establishing policies. This suggests that the founders and board members of these IIMFIs need to start grooming new cadres to replace them, as they are getting older and nearing retirement age. This could be achieved by continuing to invest in improving the competency and capacity of their staff.

Overall, the findings reveal that the complexity of the problems of accountability and governance that IIMFIs encounter is rooted in the obscurity of the IIMFIs' position. In terms of legal status, they are registered as cooperatives and hence obligated to comply with Act No. 25/1999 concerning cooperatives. The regulations stipulated in the Act are deemed inappropriate to organisational needs, such as the provision of the organisational structure of a cooperative that should comprise the board of directors, the supervisory board and the management, whereby the board of directors should at least have a chairman, a secretary and a treasurer. The interview with the chairman of the boards at BTM B revealed that the existing organisational structure was established merely to comply with the provisions of the Cooperative Act, and was not based on organisational needs. On many occasions they had to appoint people to occupy positions even though they were less capable of handling the responsibilities.

On the other hand, despite the IIMFIs currently operating more like a bank in mobilising and distributing funds from society, implementing banking regulations is deemed too complicated. The minimum amount of capital is difficult to fulfil and the monitoring mechanism is too strict. This suggests that the government should make an effort to regulate the Islamic microfinance sector by establishing a specific Act for this sector, taking into consideration the nature of the business and the supervisory mechanism in upholding its prudential operations. Moreover, since IIMFIs are allowed to mobilise funds from society, the government requires the establishment of a kind of *Lembaga Penjamin Simpanan* (Indonesia Deposit Insurance Corporation) for IIMFIs to protect the interest of depositors. Historically, such an institution was established in Indonesia with the function to recover public trust towards the banking sector following the collapse of a number of banks as a result of the financial crisis in 1997–98. Under this scheme, the government provides a full guarantee to pay a bank’s liabilities to its depositors. Hence, providing such an institution for IIMFIs will improve the level of security for savings in IIMFIs to that of banks. Ultimately, IIMFIs will continue to grow because many people trust in depositing their money in these institutions.

10.5. Limitations and areas for further study

There are no benchmarks to determine the best interpretative study as there are always criticisms and limitations of each method of interpretation, including the one adopted in this study. Therefore, this study has a number of limitations. The first is related to the methodology adopted. This study utilised the ethnographic approach, which requires the researcher to stay for long periods in the field in attempting to understand the subjective meanings that are inherent in cultures through interviews, conversations and observations. Due to financial and time constraints, the researcher was only able to allocate a week's visit to each case. Within the limited time available, the interviews were focused on internal stakeholders: the board members, the management and staff members. However, not all board members and management were interviewed, because some of them were away at that time.

The external stakeholders that affect and are affected by the practices of accountability and governance need to be included to gain better insights from both ends of the stakeholder spectrum. Therefore, future research could provide insights from a wide range of external stakeholders, such as the cooperative office at the district level, organisational members, clients and banking institutions, to explore their experiences related to the accountability and governance practised by the IIMFIs.

Observation is one of the key methods of ethnography. However, observation in this study was limited to only a number of activities. This was because the physical barriers encountered by the researcher as a wheelchair user, such as the inaccessibility of the office, hindered the possibility of observing the *shura* (consultation) meetings of the boards and the management. Given the limited time for conducting research, determining the right time for visiting the field was also essential. This was because important forums such as the annual general assembly are only held once a year.

Future research could focus on exploring the conduct of the annual general meeting, since it is considered as the highest forum for discharging accountability within a member-based organisation such as an IIMFI. Moreover, the annual general assembly is deemed to be a showcase of democratic governance practices. Thus, future studies could focus on how members participate in and influence the boards and how members of the organisation as the owner demonstrate their control over the organisation. This aspect is under-researched in the governance literature.

This study has mainly focused on the development of accountability and governance practices over different phases of organisational growth, and has paid less attention to the quality of financial disclosure and reporting issues. As mentioned in the previous section, the legal status of IIMFIs is as a cooperative, but there are no accounting standards available for cooperatives. Hence, the majority of IIMFIs adopt PSAK 59 (*Pernyataan Standar Akuntansi Keuangan* – Statement of Financial Accounting Standards) concerning Accounting for Islamic Banks. For IIMFIs, adopting this standard seems like ‘wearing oversized attire’, since the requirements for financial reporting are excessive.

The standard requires Islamic financial institutions to prepare eight components of financial reports: balance sheet, comprehensive income, cash flow, changes in equity, changes in investment, statement of sources and utilisation of the *zakah, infaq* and *sadaqa* fund, statement of sources and utilisation of the *qard hasan* fund, and notes to the financial statements. The interview with the auditor of BMT A revealed that IIMFIs are incapable of fulfilling the standards due to the lack of knowledge and experience of their human resources. Therefore, it may also be interesting for future research to investigate the quality of financial reporting of IIMFIs and how the stakeholders respond to the financial reports that they provide.

Finally, due to financial and time constraints, this study was conducted within two types of majority IIMFIs: *Baitul Maal wat Tamwil* (BMT) and *Baitul Tamwil Muhammadiyah* (BTM). There is another type of IIMFI, *Baitul Qiradh* (BQ), which is only available in *Nangroe Aceh Darussalam*. This province has been given special status and autonomy to implement Islamic law since 2001 and it is well known as the *serambi Mekkah* (veranda of Mecca). Because its culture holds strongly to Islamic values, it may be worth it for future research to explore how it builds and rebuilds accountability and governance practices. The BQ was established at a similar time to BMTs and BTMs in Java at the end of the 1990s. However, all the infrastructure in Aceh was devastated after the tsunami hit the province in December 2004, including BQ. A number of international donors have helped to reconstruct Aceh, including rebuilding BQ. Therefore, it may be interesting to explore whether the construction of its accountability and governance is affected by its own Islamic values or dictated by donors.

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APPENDICES

Appendix A Resume of previous studies of accountability and governance in the different context of microfinance institutions

Country (s)	Author(s) Period	Theoretical framework/ Methodology	Aim of study	Summary of result (s)
Conventional				
Ecuador	Rural Finance Network (2008)	Case study	To seek the effective model of governance for member-owned microfinance operate in remote areas to achieve its significant outreach	The decentralized governance for the twenty-three cooperatives in rural areas is considered as a strong model to achieve financially sustainable and operate efficiently since the central management enable to transfer surplus resources from one office that have positive balance to a deficit office that need resources for lending
Ghana	Kyereboah-Coleman and Osei (2008)	Quantitative approach	To examine the impact of governance (board size, independent and competence) on the MFIs performance	The governance mechanism is imperative in improving MFIs performance as there is a significant correlation between the independence of the board, separation position between board chairperson and CEO and MFIs outreach and profitability
	Aboagye and Otieku (2010)	Quantitative approach	To determine the association between corporate governance, outreach, reducing subsidies and the use of modern technology to the MFIs performance	The relationship between the state of corporate governance, outreach and subsidy as well as utilizes of information and communication and financial performance are weak
Indo-nesia	Hartungi (2007)	Case study	To understand the success factor of microfinance institutions in developing countries	The factors contributed to the success of microfinance bank were identified : transparent of system, tight internal control, clear of financial procedure, manage the financial risk as well as the competence staff in which all the factors are related to the scope of governance
Ireland	Hyndman et all (2004)	Mix method	To explore the information needed by the member of credit union	The financial statements prepared by the credit union contain incomplete and inadequate information for their users. Hence, the comprehensive guidance may help to improve the situation and achieve the goal of accountability for probity and legality
Kenya	Damary Sikalieh James Kaburu (N/A)	Descriptive research	To investigate governance practices in Financial Service Associations	The shareholders in the community microfinance promotes the effective governance compare to the board of directors as the user and owner bring and loyalty to the institutions
Philippi nes	Vogel and Llanto (2006)	Descriptive research	To identify the success factors in rural bank of the Land Bank	The important factors driven the success story of the Land Bank are the good policy environment, the readiness to face the environment

Country (s)	Author(s) Period	Theoretical framework/ Methodology	Aim of study	Summary of result (s)
				change as well as the proper risk management, internal audit and control. These factors are the scope of governance system.
Uganda	Kansiime (2009)	Descriptive research	To document the initiative to foster the corporate governance in the microfinance field	The adoption of governance practice by Ugandan microfinance was possible by the enactment of the Act which requires MFIs to concern on the ownership structure, financial disclosure as well as prudent management. However, code of ethic for microfinance institutions need to be design to fit with the MFIs need.
United King-dom	Hyndman et all (2002)	Quantitative approach	To provide a critical analysis of credit union's annual reports	The credit unions have provided annual report to discharge the accountability to its member, however the quality of reports were poor and need the professional accounting to assist them
Zambia	Dixon, Ritchie and Siwale (2006)	Exploratory research based on the model of vertical and horizontal of accountability	To understand and interpret the accountability in NGO microfinance	There is a tension between vertical and horizontal accountability which cause pressure and stresses among NGOs and its officers and bring the Zambian MFIs were moving into crisis
25 MFIs across the world	Champion (1998)	Survey	To summarise the current governance practices in MFIs across the world	The practices of governance between for-profit and non-profit MFIs are similar that board member work together with management. The survey revealed some issues of governance practices between those institutions
34 MFI in the Central and Eastern Europe	Harstarska (2005)	Quantitative approach	To provide evidence the impact of governance to the sustainability and outreach of MFIs	The board members play imperative role to improve MFIs performance. Moreover, better sustainability of MFIs was supported by the presence of client representation in the board. However, the role supervision of the central bank is less significant to improve their sustainability and outreach
South-east Asia	Thapa (2006)		To review the experience of MFIs in the area of sustainability and governance	The sustainability of MFIs not only require the financial viability, but also clear strategic mission and need to be transparent and efficient in its operation
114 MFIs from 62 coun-tries	Hartarska and Nadolnyak (2007)	Quantitative approach	To explore the impact of regulation as external governance mechanism on MFIs performance	The regulation less impact to the sustainability and outreach of MFIs. Hence, the transformation policy to MFIs are less relevant to achieve the sustainability of MFIs in the long-term period
40 MFIs	Bassem	Quantitative	To examine the	There is a trade-off between the

Country (s)	Author(s) Period	Theoretical framework/ Methodology	Aim of study	Summary of result (s)
in the 21 Medi-terra-nean coun-tries	(2009)	approach	relationship between governance mechanism and MFIs performance	profitability and outreach, depend on the board size and its proportions. The presence of women in the board contributes to the better performance of MFIs and the external mechanism help MFIs to improve their financial performance.
278 MFIs across the world	Mersland and Strøm (2009)	Quantitative approach	To evaluate the relationship between the outreach of MFIs and corporate governance	There is no association between external mechanism of competition and regulation to the MFIs financial performance. Moreover, the ownership type also does not affecting its performance. However, the characteristic of board member such as female member and local board are contributing to improve MFIs performance.
30 coun-tries	Hartarska (2009)	Quantitative approach	To investigate the effect of external governance mechanism on the MFIs performance	The regulatory involvement and financial transparency are not significant in determining MFIs outreach and sustainability. However, the microfinance rating agency may play role in disciplining microfinance.
558 MFIs of 80 coun-tries	Müller and Uhde (2009)	Quantitative approach	To study the impact of external governance structure to the economic success of MFIs	The quality of external governance affect significantly to the economic success of MFIs with represented by the indicators : ROA and operational self-sufficiency
59 MFIs of South Asian coun-tries	Manderlier, et all (2009)	Quantitative approach	To explore the influence of a set of governance mechanism to achieve both the social and profit goals of MFIs	A set of the important of governance mechanism : board size and its characteristics, the ownership structure and political-legal environment are unsuccessful to affect financial performance and to wider its social impacts
531 MFIs across the world	Arun and Annim (2010)	Quantitative approach	To verify the correlation between the external governance mechanism and the dual missions of MFIs	The external governance indicators are not significant in improving the profitability of MFIs, but becoming important variables for the poverty alleviation objectives of MFIs
N/A	Mersland (2011)	Historical studies	To present the lessons learnt from the governance mechanism practiced by saving banks	The imperative factor securing the survival of saving bank was the monitoring mechanism provided by bank association, depositors, local communities and donors
281 MFIs in Africa	Barry and Tacneng (2011)	Quantitative approach	To analyse the effect of external governance to performance in different types of MFIs	The study compares the performance of different types of MFIs as is follow: bank, cooperative, NGO and non-bank and indicate that NGO is the best institution to achieve the social goal of microfinance. The regulating body as external

Country (s)	Author(s) Period	Theoretical framework/ Methodology	Aim of study	Summary of result (s)
				governance mechanism is essential to improve MFIs efficiency and productivity
443 MFIs of 162 coun-tries	Hartarska and Mersland (2012)	Quantitative approach	To evaluate the impact of several governance mechanism to the outreach	The board size affect the efficiency of MFIs to reach more poor people, but the representative of donor in the board is not beneficial to improve its performance. Moreover, MFIs perform better when they were supervised by the independent authority.
Islamic microfinance				
Indo-nesia	Adnan et all (2003)	Quantitative approach	To seek the success factors of IMFIs	The management's background (educational level and its experience) and their salary rate are the factors that influence the IMFIs' performance
Indo-nesia	Wahyuni (2007)	Survey	To compile challenges encountered by IMFIs in their accounting activities and generating financial reports	Four challenges faced by IMFs : lack of knowledge on Islamic banking law, the absence of accounting standards for IMFIs, poor human resource and inappropriate the informational technology infrastructures
Indo-nesia	Wahyuni (2008)	Quantitative approach	To understand the accountability practices in IMFIs	The rapid development of IMFIs was not followed by the development of accounting and reporting standards for this sector. The IMFIs are not required to produce financial report, but most of them print a balance sheet on monthly basis and only a few of the report were audited by independent auditors
Indo-nesia	Wardiwiyono (2012)	Quantitative approach	To investigate the internal control mechanism within IMFIs	The internal control system in IMFIs was implemented adequately which focus on the information and communication, monitoring, control environment, risk assessment and control activities. However there is still a weakness in the control system as the lack of authorization procedure and the presence of Shari'ah Supervisory Board.
Indo-nesia	Husen and Sa'rono (2012)	Quantitative approach	To identify the factors (ownership, good managerial and networking) driven the success of BMT Berkah Cimanggis	The ownership, good managerial and networking affect significantly to increase the financial performance (liquidity, solvency, and profitability)

Studies on Islamic microfinance

Country (s)	Topic	Author(s) Period	Theoretical framework/ methodology	Aim of study	Summary of result
Indonesia	Culture and IMFIs	Saefullah (2010)	Institutional culture and external culture/ case study	To explore the perception of management on the importance of understanding cultures as one of the success factors of BMTs	There is a propensity to neglect the issue of culture (ethnicity, gender, urban/migrant, client's background) among the management of IMFIs
Indonesia	Sustain-ability of IMFIs	Cokro, et all (2008)	Quantitative approach	To analyse the technical efficiency and outreach of IMFIs to estimate their sustainability	In general, IMFIs operates lower than the optimal scale which implies that IMFIs encounter managerial problem in maximising its resources
Indonesia	Sustain-ability of IMFIs	Masyita (2012)	Quantitative approach	To examine the supply and demand related to the operation and growth of IMFs	The demand of MFIs was based on economic reasons (low interest and size of loan). On the other hand, the supply of IMFIs can be enhances by integrating microfinance and waqf/endowment.
Indonesia	Gender and IMFIs	Sakai (2010)	Case study	To seek the impact of the IMFIs to female	The IMFIs contribute to improve the self-worth of women and obtain their financial independence as the majority of IMFIs clients were women traders
Indonesia	Perfor-mance	Masyita and Ahmed (2013)	Quantitative approach	To identify the demand factors of IMFIs by examining the perceptions, understanding and preference of their clients	The decision to chose the financial service institutions mainly driven by economic reasons (low interest rate, size of loan and collateral) and non-economic factor such as the easiness, speed, nearness, officer's loan and the payment method)
Indonesia	Perfor-mance	Agus Eko Nugroho (2008)	Conceptual paper	To examine the link between social capital and MFI's performance	Trust and network as forms of social capital play significant role to improve MFIs performance as it becomes effective tool to provide sanction and peer pressure for loan defaulters
Australia	The growth of	Ahmad and	Exploratory study	To examine the co-operative nature of	There is a sign for the growth and

Country (s)	Topic	Author(s) Period	Theoretical framework/ methodology	Aim of study	Summary of result
	MFIs	Ahmad (2009)		IMFIs	development of IMFIs in the future although they are now still operating in a small size, assets and investors. The development can be boosted through attracting more capital and integrating the investment and retail banking
Jordan	Risk of IMFIs	Aburish (2013)	Quantitative approach	To identify the characteristic and preference of the borrowers	The borrowers of IMFIs are more religious compare to conventional MFIs users and the Islamic borrower tend to have risk-seeking preference
Pakistan	The socio-economic impact of IMFIs	Khan et all (2011)	Quantitative approach	To examine the impact of microfinance program to the standard life of poor people	The program plays significant role in providing credit for the poor and training for them. However, the effectiveness of program can be enhanced by introducing other Islamic financial instruments
	Poverty and IMFIs	Sh and Ramzan (2012)	Case study	To elucidate the effective development tools to reduce poverty	The integration of micro-entrepreneurship, social entrepreneurship and microfinance are considered as the effective way to minimize poverty and contribute toward sustainable development
		Khaleequz zaman and Shirazi (2012)	Conceptual paper	To illustrate the drawback of conventional MFIs and introduce Islamic MFIs to alleviate poverty	Islamic MFIs is considered as an effective way to eradicate poverty as Islamic values provide in-built mechanism of creating trust between clients and IMFIs which enable to share the responsibility to share the profit and loss
Thailand	Client's perceptions on IMFIs	Naipom (2012)	Quantitative research	To assess the perception of customers toward product, impact,	The demand for MFIs is influenced by the customer's need during the life-cycle event, the

Country (s)	Topic	Author(s) Period	Theoretical framework/ methodology	Aim of study	Summary of result
				performance and scope of IMFIs	affordability as well as the awareness of regulations and procedures relate to IMFIs
Yemen	Service quality of MFIs	Fararah and Al-Swidi (2013)	Quantitative approach	To examine the impact of service quality of MFI to the customer satisfaction	The service quality of MFIs affect the customer satisfaction and perceived benefit significantly
N/A	MFIs and poverty alleviation	Kaleem and Ahmed (2010)	Conceptual paper	To seek the guidance from *Quran* verses to develop a charity-based model of IMFIs	The charity-based model of MFIs is considered as a financially and socially sustainable because it is driven by the Islamic concept of brotherhood, local philanthropy as well as volunteer service
		Rahman (2010)	Conceptual paper	To evaluate the applicability of Islamic finance products for microfinance sector	Some Islamic finance instruments can be adapted and advance in the interest of microfinance institutions
		Smolo and Ismail (2011)	Conceptual paper	To discuss the contractual framework in modelling MFIs	There is a great potential for IMFIs to grow in the future as the variety source of fund to finance the loan and wide range of financial instruments to meet the different needs of its clients.
		Ali (2011)	Conceptual paper	To describe how IMFIs can be an effective tool to alleviate poverty	The zakah (Islamic tax) and microfinance are considered as powerful tools to help poor people to solve exit from poverty cycle
	Sharia's sompliance	Komi and Croson (2013)	Experimental research	To test and describe the compliance of IMFIs product with the Islamic law	The Islamic contract loan (profit-sharing and joint venture) in IMFIs proof significantly compliance with the Islamic principle
	The challenges of IMFIs	Rahman and Dean (2013)	Conceptual paper	To highlight the challenges encountered by IMFIs	The challenges of IMFIs were identified: low market penetration, sustainability due to high administration cost and lack of fund mobilisation as well as the effectiveness of IMFIs to alleviate poverty. The solutions

Country (s)	Topic	Author(s) Period	Theoretical framework/ methodology	Aim of study	Summary of result
					offered : increasing bank participation in microfinance, improving network, providing regulation and policy
	Product innovation of IMFIs	Saad and Razak (2013)	Conceptual paper	To introduce the application of *musharakah mutanaqisah*/ diminishing partnership contract in the context of MFIs	The equity financing product based on *musharakah mutanaqisah* concept is considered as a product that more applicable for IMFIs to achieve their goals in helping poor people to improve their socio-economic conditions

Appendix B Interview Guide for examining field of Islamic microfinance in Indonesia

Themes

1. Historical background
   a. How was the institution established? When?
   b. Who was behind the idea for establishing this organisation?
   c. What was the objective or aim for setting up this organisation?
   d. Who provided support for the organisation during the time of the establishment until the present?
2. Role of organisation in supporting IMFIs
   a. What is the structure of your organisation?
   b. What are the main roles played by your organisation in the development of IMFIs in Indonesia?
   c. What type of support is provided by your organisation to IMFIs? Providing capital? Delivering training? Monitoring the operations of IMFIs?
   d. What are the main achievements of the organisation?
3. Challenges faced by IMFIs in Indonesia
   a. What are the main challenges encountered by IMFIs and how your organisation can help in overcoming such challenges?
   b. What methods were adopted by your organisation to coordinate activities of IMFIs?
   c. What are the factors that contribute to failure of some IMFIs? How your organisation help in preventing failures?
   d. There are a number of associations of IMFIs in Indonesia. Why they emerged? Why they do not unite into single association?
4. Supervision of IMFIs
   a. Do you think IMFIs should be regulated? Why? If yes, what aspects should be regulated?
   b. What is the role of the Indonesian Ministry of Cooperative in monitoring and supervising IMFIs? Do you think that IMFIs should be under the supervision of this Ministry? If yes, why? If no, which governmental body should supervise IMFIs?
   c. Should IMFIs be supervised by the Central Bank? Why?

Interview guide for examining field of Islamic microfinance in Indonesia (translated)

Tema

1. Sejarah pendirian
    a. Bagaimana organisasi ini awalnya didirikan? Kapan?
    b. Siapa yang memiliki ide untuk mendirikan organisasi ini?
    e. Apa maksud dan tujuan didirikannya organisasi ini?
    f. Siapa saja yang berperan memberikan dukungan terhadap organisasi, baik saat didirikan sampai sekarang?
2. Peranan organisasi dalam mendukung BMT
    a. Bagaimana struktur organisasi anda?
    b. Apa peran yang dijalankan organisasi anda dalam mengembangkan BMT?
    c. Dukungan seperti apa yang diberikan organisasi anda kepada BMT? Menyediakan modal? Menyelenggarakan pelatihan? Melakukan pengawasan terhadap operasional BMT?
    d. Apa pencapaian terbesar yang diraih organisasi anda?
3. Tantangan yang dihadapi BMT di Indonesia
    a. Apa tantangan berbesar yang dihadapi BMT dan bagaimana organisasi anda membantu BMT untuk mengatasi tantangan tersebut?
    b. Bagaimana metode yang anda terapkan, apakah melakukan koordinasi dengan BMT yang ada?
    c. Faktor apa saja yang menyebabkan kegagalan BMT? Bagaimana peran organisasi anda membantu untuk mencegah kegagalan ini?
    e. Ada beberapa macam asosiasi BMT di Indonesia. Bagaimana mereka muncul pada awalnya? Mengapa mereka tidak bergabung saja dalam satu asosiasi?
4. Pengawasan terhadap BMT
    a. Apakah menurut anda BMT ini harud diregulasi? Mengapa? Jika ya, aspek apa saja yang perlu diregulasi?
    b. Bagaimana peran Kementerian Koperasi dalam melakukan pengawasan dan supervise terhadap BMT? Apakah menurut anda BMT harus di bawah pengawasan kementrian Koperasi. Jika ya, mengapa? Jika tidak, lembaga mana yang seharusnya melakukan pengawasan terhadap BMT?
    c. Apakah BMT selayaknya disupervisi oleh Bank Sentral? Mengapa?

Appendic C Consent letter

UNIVERSITY OF Hull

Business School

To whom it may concern

I am writing to confirm that Wuri Handayani is my PhD student at the University of Hull Business School. She is currently conducting a research with the title "Accountability and governance in Islamic microfinance institutions in Indonesia", funded by the World Bank.

As part of her study, she is required to conduct interviews with members of Islamic microfinance institutions and observe activities related to accountability and governance practices within the organisation. The purpose of the interview is to seek the participants' understanding of accountability and governance, how they discharge accountability and how governance mechanisms are implemented within the organisation. Therefore, it would be greatly appreciated if you could provide permission for Wuri Handayani to conduct her interviews and observations in your organisation. I will be supervising the development of her research and if you need any further information, please do not hesitate to contact myself or Wuri Handayani. The following are further particulars related to the conduct of the study in your organisation:

- Each interview is estimated to be no more than 1 hour and the participant is free to choose the convenient time and location within the organisation for the conduct of the interview.
- Each participant will be asked permission to record the interview using digital recording.
- During the interview, participant can decline to answer some questions or completely withdraw participation at any point without giving any explanation.
- The interview will be transcribed as soon as possible and the participant will have the opportunity to amend or comment on the transcription.
- All information related to the participant and organisation will be kept anonymous and identified only by codes.
- The recordings and transcriptions will be placed in a secure location and will only be accessible to Wuri.
- An interview guide and consent form is attached.

Yours sincerely

Roszaini Haniffa

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Appendix D Consent form for institution/organisation

UNIVERSITY OF Hull
Business School

RESEARCH ETHICS COMMITTEE

CONSENT FORM – For Institutions/Organisations

I, H.Dumaini Nor of Directors

Hereby give permission for BMT MMU Sidogiri

to be involved in a research study being undertaken by Wuri Handayani

and I understand that the purpose of the research is to :

explore and understand accountability and governance practices are developed in Islamic microfinance in Indonesia

and that involvement for the institution means the following:

- Giving permission to conduct interview to the boards and managements
- Providing access to do some observations
- Allowing researcher to conduct research for certain periods

I understand that

1. the aims, methods, and anticipated benefits, and possible risks/hazards of the research study, have been explained to me.

2. I voluntarily and freely give my consent for the institution/organisation to participate in the above research study.

3. I am free to withdraw my consent at any time during the study, in which event participation in the research study will immediately cease and any information obtained through this institution/organisation will not be used if I so request.

4. I understand that case studies will be used for research purposes and may be reported in scientific and academic journals, non academic publications and the internet.

I agree that

5. The institution/organisation ~~MAY~~ / MAY NOT be named in research publications or other publicity without prior agreement.

6. ***I / ~~We DO~~ / DO NOT require an opportunity to check the factual accuracy of the research findings related to the institution/organisation.***

7. ***I / ~~We EXPECT~~ / DO NOT EXPECT to receive a copy of the research findings or publications.***

Signature: Date:

disetujui oleh.
Manager Koperasi
BMT-MMU.

KOPERASI BMT - MMU SIDOGIRI
JAWA TIMUR

Appendix E Sample interview guide (English)

GOVERNANCE ASPECT

No.	Sub aspect	Bourdieu's aspect	Questions	Prompts/probes
1	Organisational structure	Habitus and practices	Is there an organisational structure?	If yes, is the structure clear? If not clear, why? How can it be improved? If no organisational structure, why not?
			Has the structure ever been revised/amended?	If yes, when? Why was it amended?
			Is there a job description for every position within the organisation?	If yes, are employees aware? If no, why not?
			Can you explain the organisational structure and who is in charge?	• Ask them to draw the organisational structure, name of the persons in each position and their general duties •
			How many people are at the management level?	• What is the position? Director? Vice director? • How many departments do you have? Marketing? Finance? Accounting? Etc?
			Does the organisation have a supervisory board?	If yes, how many people on this board? What are their roles? What is the process for nominating supervisory board member? Are there any criteria/ minimum requirement in order to be nominated as a supervisory board member? Who appoints the supervisory board member? • • If no, why not?
			Does the organisation have an advisory board?	If yes, how many people on this board? What are their roles? What is the process for nominating advisory board member? Are there any

Appendix E Sample interview guide (Indonesia)

PIHAK YANG PERLU DIWAWANCARAI

No	Para pihak	Informasi yang ingin didapatkan

1	Pendiri	- Sejarah berdirinya BMT Sidogiri → klarifikasi ulang : dari Kopontren, MMU dan UGT
		  - Apakah strukturnya sama? Pengurusnya sama? Bidang usahanya? Target market?
		  - Bagaimana hubungan antara BMT Sidogiri dengan cabang2nya? Apakah saling terkoneksi seperti hubungan induk-anak (dalam konteks akuntansi)
		- Bagaimana awalnya mendapatkan pelatihan mengenai BMT syariah? Darimana? Siapa saja yang mendapat pelatihan? Bagaimana ilmu yang didapatkan ini disebarkan/ditularkan kepada karyawan yang lain?
		- Perkembangan Sidogiri dari masa ke masa
		- Visi, misi, tujuan dan rencana pengembangan BMT. Apakah visi, misi dan rencana ini disusun secara tertulis dan dievaluasi secara periodic? Bagaimana proses perumusan visi dan misi? Bagaimana evaluasi pencapaian visi dan misinya. Bagaimana mekanisme untuk memastikan bahwa organisasi dikelola tidak menyimpang dengan visi dan misinya? Bagaimana strateginya?
		- Tantangan dan hambatan
		- Legal formal organisasi →
		  a. Bagaimana proses mendapatkan legal formal organisasi?
		  b. Apakah memiliki AD/ART → apa saja yang diatur dalam AD/ART? Siapa yang menyusun AD/ART?
		  c. Mengapa koperasi, apakah ada rencana untuk berubah menjadi bank, dll
		  d. Apakah didaftarkan dalam institusi pemerintah? Mengapa? Bagaimana prosesnya?
		- Bagaimana sistem pertanggungjawaban dalam koperasi (bandingkan dengan koperasi langit biru)
		- Apakah Bapak memahami bagaimana risiko yang dihadapi BMT di masa mendatang? Bagaimana risiko ini dapa diminimalkan?
		- Apakah bentuk usaha koperasi sudah paling sesuai dengan organiasi ini?

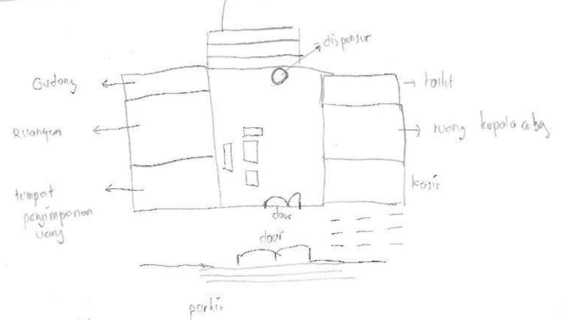
2	Pengurus →
	masing-masing :
	- ketua
	- sekretaris
	- bendahara
	- lainnya
		- Tugas, tanggung jawab dan wewenang
		- Data umum organisasi (mengacu pada survey BMT di Indonesia)
		- Data personal, lama pengalaman di bidang BMT
		- Bagaimana proses pemilihan menjadi pengurus (baik ketua, sekretaris, bendahara, dll)
		
		- Bendahara : Aspek keuangan
		  a. Sumber dana, darimana digali/dikumpulkan? Jelaskan internal dan eksternal? Mana yang dominan? Bagaimana pengurus mendapatkan dana eksternal? Jelaskan..... Apakah ada pemisahan pengelolaan antara dana internal dan eksternal?
		  b. Apakah ada dana eksternal (pinjaman dari bank/institusi lain)? Bagaimana mengelola pinjaman?
		  c. Bagaimana pengelolaan zakat? Lembaga apa yang didirikan?

Appendix G Sample of field notes

1

Refleksi H-1 – 23 Sept 2012. (Sunday 10.30 – 13.50)

- Diskusi informal dgn Bpk Saikhon → ternyata kepala cabang Sidogiri
  ↓ sambil menunggu Bpk. Dumairi rapat } orangnya cukup ramah
- Rapat rutin – Rabu – tk cabang
  - Sabtu – tk managerial
  - Minggu – tk pengurus + manager
- Menjelaskan / memberikan daftar pertanyaan kpd para pihak → informasi apa saja yg dibutuhkan
- Hampir semua menggunakan sarung (khas pesantren NU) → hari ini dgn ham warna biru
- Ruang tamu penuh dgn bbrp peralatan komputer → u/ pembukaan cabang baru di Lumajang
- Denah kantor



- Banyak orang/staf mondar-mandir → ≠ jelas
- Pelayanan cukup banyak → diatur dgn nomor antrian
- ± pukul 12.15 → pengurus + manajer → selesai rapat
  → diperkenalkan dgn staf yg lain
- ± pukul 12.30 → adzan di ruang pelayanan
  → pelayanan dihentikan sesaat → staf sholat Dhuhur berjamaah
  →
- Diskusi dgn manager marketing → penjelasan ttg produk**