The Mediating Role of Perceived Benefits upon SMEs' Satisfaction towards Islamic Microfinance Institutions

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Abstract: This study is aimed at investigating the relationship between Islamic microfinance institutions service quality and the satisfaction of small and microenterprises in Indonesia by using perceived benefits as mediating variable. Primary data are collected from 454 small and microenterprises (SME) located in West Java Province and the CARTER Model is adopted to test the satisfaction of small and microenterprises upon the services provided by their patronized Islamic microfinance institutions. By using the structural equation model, the finding confirms that perceived benefits fully mediate the relationship between service quality of Islamic microfinance institutions and small and microenterprises' satisfaction.

1 INTRODUCTION

Abduh (2013) investigated the prioritizing issues in Islamic economics and finance (IEF) by using analytical hierarchy process and found that area of *zakat-waqaf* and poverty alleviation is considered as the most important area followed by monetary system including Islamic currency. Despite the large number of studies done in Islamic banking, the respondents have considered that the area is not able to answer or give solution to the current problem of poverty in Muslim society.

Nowadays, microfinance is believed as one of the most significant tools to narrow the income distribution gap among the people and eventually to alleviate poverty. It is a new initiative which is acclaimed to bring a new paradigm of economic development which is not only focusing on growth but also on equality and quality of the development. However, the implementation of *riba*-based loans and other non-Islamic approaches in conventional microfinance institutions avoids many Muslim SME entrepreneurs to go for its products and services.

Masyita and Ahmed (2011) reported that the demand for Islamic microfinance institutions' (IMFIs) services is very high in Muslim majority developing countries like Indonesia, Bangladesh, and Pakistan despite the fact that most of the IMFIs are informal institutions. In Indonesia, the IMFIs are part of its microfinance system since 1990, when the first Islamic cooperative of *Baitul Maal wat-Tamwil* (BMT) was established. It was established in order to provide Muslim SME owners with shariah compliance financial products and services. Masyita and Ahmed (2011) also reported that as many as 72% people live in Muslim countries do not use formal financial services in fulfilling their needs, and thus the existence of IMFIs is very helpful for them, especially the lower income group.

However, despite all the advantages offered by IMFIs to the SME owners, there still barriers in the market between the two stakeholders in Indonesia. Among the identified barriers is the high transaction cost charged by IMFIs. The reason is that the IMFIs are not only channeling funds and do the monitoring, administrating, and collecting the payment, but also guiding and nurturing their customers on how to improve their economic situation. Moreover, the absence of physical collateral, which pushes IMFIs to face more probability of credit default risks than the conventional microfinance has increased the transaction costs of IMFIs. Nevertheless, one of the reasons why IMFIs are still growing is because the transaction costs are still below the cost demanded by banks. Table 1 shows the development of BMT as the dominant IMFIs in Indonesia from 1990 to 2013, which is very impressive in terms of the number.

Table 1: The Development of IMFIs in Indonesia from 1990 to 2013.

Year	Number of BMT
1990-1995	300
1996	700
1997	1501
1998	2470
2000	2938
2001	3,037
2003	2,856
2012	3900
2013	7500

With the big number of IMFIs and other microfinance institutions in Indonesia, IMFIs have to compete with not only other IMFIs but also with other major financial institutions such conventional microfinance institutions, banks, and leasing companies. In this competitive market, it is vital for the IMFIs to enhance its quality of services in order to maintain the existing customers and attract more in the future.

2 LITERATURE REVIEW

2.1 The Role of IMFIs

Many have said that commercial banking has failed to provide financial services to the poor and catering market at micro level. As a consequence, microfinance, especially IMFIs, had emerged as an economic development institution that has a competitive advantage to serve financial needs of the lower income groups in the society. Al-Harran (2000) explained that among the purpose of the establishment of IMFIs is to create financial services that can be accessed by the non-bankable people and to improve their economic performance.

In the case of Indonesia, BMT was established in order to empower Muslim small and micro-entrepreneurs and to enhance the welfare of the general Muslim. In addition, BMT was set to provide Muslim with shariah compliance methods of financing and fostering productive businesses in order to increase job opportunities that can help government to reduce the unemployment rate.

BMT as the dominant IMFIs were proven to be able to improve business performance of SMEs effectively. Using 60 BMTs and 204 SMEs located in Central Java as research samples, Hadisumarto and Ismail (2010) reported that the business performances of SMEs including its business income, profit, and assets, had improved significantly after they joined and received financing from the BMT.

2.2 Service Quality of IMFIs

Excellent service quality is believed could retain the existing customers and at the same time attracting new customers as the words-of-mouth impact from the satisfied consumers. For financial institutions, quality service is about meeting the requirement and needs of their customers and the delivery of customers' expectation. Abduh and Othman (2014) argued that in today's global economy, quality is a survival factor for organization because of the shifting in the world economy from a production-led philosophy to a customer focused approach. In other words, the ability of delivering customer service would determine the effectiveness of a firm.

Parasuraman et al. (1985) identified 10 dimensions of service quality in financial industry as follows: reliability, responsiveness, competence, access, courtesy, communication, credibility, security, competence, understanding, and tangibles which later on simplified into 5 dimensions which are reliability, responsiveness, assurance, empathy, and tangibles. Othman and Owen (2001) expanded the SERVQUAL model of Parasuraman et al. (1985) by adding compliance dimension as one item regarding to measurement of Islamic financial institution. This indicator tried to measure the shariah compliancy of services provided by Islamic financial institutions. Items included in this dimension are: operational of the institution refers to Islamic teaching; no interest in deposit and financing; and services and products offered are not against sharia law. This model is known as CARTER Model.

Fararah and Al-Swidi (2013) is among the first paper evaluated the service quality of IMFIs using CARTER model. The study was aimed to examine the relationship between service quality, perceived benefits and satisfaction. The finding had shown that there is a positive and significant impact of the perceived benefits on the satisfaction level of SME owners towards IMFIs service quality at 1 percent level of significance. The study has also revealed that the relationship between service quality and satisfaction of IMFIs customer is also positive and significant.

Although there is no study yet that discuss the factors influence SME owners in Indonesia to choose IMFIs, study in Islamic banking such as Abduh (2011) have shown that customers in Indonesia had perceived sharia compliance and assurance as the most important dimension in choosing the Bank.

2.3 Customer Satisfaction and Loyalty

Abduh et al. (2012) explained that customer satisfaction is a measure of how organization's total product performs in relation to a set of customers' requirements. Therefore, in the industry of financial services, financial institutions should be more focusing on increasing customer satisfaction to retain them by improving the service quality level of their institution.

Levesque and McDougall (1996) posit that satisfied customer leads to the higher profit of the organization, therefore customer satisfaction becomes one of the most important elements in the successfulness of the business. In addition, the positive effect of customer satisfaction is the enhancement in customers' trust and loyalty, and eventually will improve the profit of the organization. Therefore, it is a strategic issue for the organizations to increase customer satisfaction and maintain their loyalty which indirectly if will give impact upon the economic returns, i.e. profitability, market share, and return on investment (Anderson et al., 1994).

2.4 Perceived Benefits

Perceived benefit refers to the perception of the positive consequences that are caused by a specific action. Services providers could lose their customers if customers perceive no benefit or a little benefit will be obtained from the programs (services or products), likewise the customers would be motivated to give their loyalty if they perceive more benefits would be obtained from the programs and it surely increases the relationship between them and the providers.

2.5 Research Hypotheses

The determination of customers satisfaction on Islamic banking products and services have been broadly examined by many researchers both in Muslim and non-Muslim countries. In contrast, research on Islamic Microfinance regarding the issue of customer satisfaction is still rare. The proposed research hypotheses to be tested in this study as follow:

- H1: Service quality has a positive and significant effect on the satisfaction of SME owners;
- H2: Service quality has a positive significant effect on perceived benefits of SME owners;
- H3: Perceived benefits have a positive and significant effect on the satisfaction of SME owners;

- H4: Perceived benefits mediate the relationship between service quality and SME Owners' satisfaction upon IMFIs performance.

3 DATA AND METHODOLOGY

3.1 Data

The data are obtained through a survey in November 2014 using structured questionnaire consisting of four parts i.e. demographic, service quality, perceived benefits, and customer satisfaction. The respondents are SMEs owners and the scope are the Province of Jakarta, West Java, and Banten. A total of 454 units of questionnaires were received and analyzed for this research.

3.2 Structural Equation Model

Confirmatory factor analysis (CFA) is a type of SEM analysis that deals specifically with measurement models; that is, the relationships between observed measures or indicators and latent variables or factors. In confirmatory factor model approach, we choose to statistically test the significance of a hypothesized factor model in order to know whether the sample of data confirms the model or not. The sample data that fits the model confirms the validity of the hypothesized model. This is primarily the rationale for CFA.

The validity of measurement model is based on the acceptance of the model goodness-of-fit alongside with specific proof of construct validity which is the degree to which data collection methods properly measure what they were intended to measure. To fulfill the validity and reliability procedures, convergent validity and items reliability (Cronbach's alpha) will be carried out.
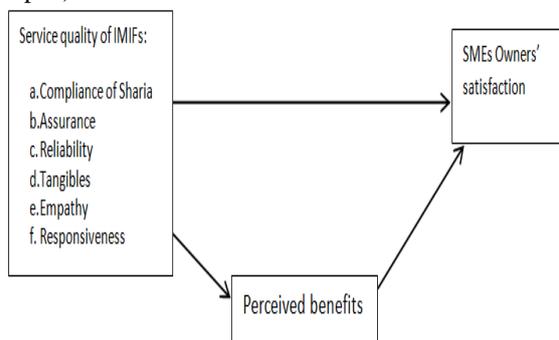

Figure 1: Model proposed and tested in this study.

Numerous of indices will be used in this study to assess the goodness of fit between the model and the sample of data. These indices include: Chi-square/df$\chi2$, Comparative Fit Index (CFA), Root Mean Square Error of Approximation (RMSEA), and Normed Fit Index (NFI).

4 FINDINGS AND DISCUSSION

4.1 Demography

The demography of the respondents of this study is reported in Table 2. The figures indicate that 56.8% of the respondents are male and 43.2% female, with most of them are married (85%). In term of education, most of the respondents are graduated from Senior High School, only 25.6% were graduated from colleges. The majority of respondents are in the group age of 31 – 40 years followed by 21 – 30 years (27.8%). With regard to their income, 49.1% are in the group of $80-$215 per month, followed by the group of $250-$415.

Table 2: Demographic information of the respondents.

Variables	%
Gender	
Male	56.8%
Female	43.2%
Marital Status	
Single	15.0%
Married	85.0%
Age	
Below 20 years old	1.3%
21-30	27.8%
31-40	55.9%
41 +	15.0%
Background of Education	
Primary School	4.2%
Junior High School	13.0%
Senior High School	57.3%
Diploma/University	25.6%
Monthly Income	
Below Rp 1 million ($80)	9.9%
≥ Rp 1 Mill. - Rp 3 mill. ($80-$215)	49.1%
>Rp 3 Mill. - Rp 5 mill. ($250-$415)	32.4%
>Rp 5 Mill. ($415)	8.6%

4.2 Convergent Validity

The significant factor loadings indicate convergent validity. According to Barclay (1995), the ideal degree of standardized factor loading should be .70

and above. However, .60 is still accepted by many researchers.

Table 3 shows that all of the items have a good value in which all factor loadings have a sufficient score requirement. The highest convergent validity is accounted by the item SC3 which is refers to "products accepted by Islamic Law" with score of 0.934, and followed by the item CS41 which is refers to "It is Very satisfied with personal" with score of 0.926. Overall, the values exceed 0.6 and many are more than 0.7 and 0.8; it shows evidence that the model provides a good validity.

Table 3: Standardized factor loadings of construct items.

Observed Variables		Factors	Standardized Factor Loading
SC3	<---	SCOM	0.934
SC2	<---	SCOM	0.866
SC1	<---	SCOM	0.888
As9	<---	ASSUR	0.753
As6	<---	ASSUR	0.669
As7	<---	ASSUR	0.677
Re13	<---	RELI	0.737
Re12	<---	RELI	0.806
Re11	<---	RELI	0.720
Ta19	<---	TANG	0.756
Ta18	<---	TANG	0.865
Ta16	<---	TANG	0.653
Em29	<---	EMPA	0.734
Em26	<---	EMPA	0.639
Em24	<---	EMPA	0.763
Res32	<---	RESP	0.962
Res31	<---	RESP	0.566
Res30	<---	RESP	0.568
CS40	<---	CS	0.517
CS41	<---	CS	0.926
CS42	<---	CS	0.840
PB33	<---	PB	0.746
PB37	<---	PB	0.679
PB35	<---	PB	0.726

Note: SCOM = Shariah compliance; ASSUR = assurance; RELI = reliability; TANG = tangible; EMPA = empathy; RESP = responsiveness; CS = Customer satisfaction; and PB = perceived benefits.

4.3 Reliability Test

Cronbach's Alpha is the common measure of internal consistency (reliability). The value of Cronbach's alpha should be greater than minimum standard of 0.7 (Nunnelly, 1978). The results of this study showed a good estimate of internal consistency for all latent variables under investigation. The values of Cronbach's alpha shown in Table 4 below ranges between .767and .858 for each latent variable in the proposed model except for the variable of Responsiveness which shows .676 for its Cronbach's Alpha value.

4.4 Assessing the Measurement Model

The findings show that almost all factor loadings were respectively strong and all statically significant, but the model showed unsatisfactory for some test indices. The fit indices for the sample are: chi-square to degrees of freedom (χ^2/df) = 6.982, CFI = 0.658, NFI = 0.623, IFI = 0.659, TLI = 0.636 and RMSEA = 0.11.

Table 4: Cronbach's alpha reliability test.

Latent Variables	No. Items	Cronbach's α
Sharia Compliances (SCOM)	3	0.858
Assurance (ASSUR)	3	0.786
Reliability (RELI)	3	0.848
Tangible (TANG)	3	0.794
Empathy (EMPA)	3	0.762
Responsiveness (RESP)	3	0.676
Perceived Benefits (PB)	3	0.767
Customer Satisfaction (CS)	3	0.815

Model re-specification is aimed at improving the original model into a better goodness of fit. According to Hu and Bentler (1999), if CFI and NFI scores are greater than .90 and the Root mean square error of approximation (RMSEA) value is less than .08, then the indices show a good model fit. Table 5 shows the goodness-of-fit statistics of the model and the statistics after the modification of the model show significant improvement with CMIN/DF is 2.143 and other indices are greater than 0.90.

Table 5: Baseline comparisons of the modified model.

Model	NFI	RFI	IFI	TLI	CFI
Default model	0.942	0.916	0.968	0.953	0.968

As suggested by Steiger and Lind (1980), the RMSEA score 0.05 and below shows the good fit of the model tested. Table 6 shows that the RMSEA value of our hypothesized model is 0.05, with the 90% confidence interval ranging from 0.044 to 0.057 and the p value of this test of closeness of fit equal to 0.468. This means that we have 90% confidentiality to conclude that the RMSEA in the population with the bound area 0.044 to 0.057 as a good precise degree. Theoretically, this result indicates that the model is fit and thus the proper interpretation would not likely to be spurious.

Table 6: RMSEA of the modified model.

Model	RMSEA	LO90	HI90	PCLOSE
Default model	0.05	0.044	0.057	0.468

4.5 The Relationship among Variables

Table 7 provides the standardized regression estimates I which shows the direction and the magnitude of the investigated relationships in the full model.

Table 7: Standardized regression estimate I.

Relationship Direction			Est. (B)	P-value	R²
PB	←	SQ	0.658	***	0.433
CS	←	SQ	0.039	0.501	0.328
CS	←	PB	0.546	***	
ASSUR	←	SQ	0.884	***	0.782
SCOM	←	SQ	0.578		0.334
RELI	←	SQ	0.764	***	0.583
TANG	←	SQ	1.027	***	0.550
EMPA	←	SQ	0.728	***	0.530
RESP	←	SQ	0.619	***	0.384

Interestingly, this study provides no evidence to show that service quality has a significant influence upon customer satisfactions (p-value .501). However, it does have a significant influence upon perceived benefits and perceived benefits significantly influence the customer satisfaction. Therefore, there is a strong indication that the relationship between service quality and customer satisfaction in the Islamic microfinancing industry in Indonesia is fully mediated by the perceived benefits of the customers. The findings support hypotheses 1 and 3, and rejecting hypothesis 2.

Table 7 also provides the information of regression weight between service quality to the first-order factor of service quality or CARTER (Compliances, Assurance, Reliability, Tangibility, Empathy, and Responsiveness). The statistics displayed in Table 7 are showing that significant relationship exist among them which means that between first order CFA and its second order is a good-fit model.

4.6 Mediation Analysis

To assess the mediating role of perceived benefits in between service quality and customer satisfaction of SMEs' owners upon the performance of Islamic Microfinance Institutions, the non-mediated model will also be run in order to compare the direct and indirect effects. In this way, the role of perceived benefits in mediating service quality towards customer satisfaction can be identified.

When both independent and mediating variable appear in the model, the relationship between independent and dependent variable is no longer significant, with the strongest demonstration of

mediation occurring when the direct independent variable to dependent variable path is zero.

Table 8: Standardized regression estimate II.

Relationship Direction			Est. (B)	P-value
CS	←	SQ	0.350	***

Table 8 of the standardized regression estimate for the model without perceived benefits variable and Figure 2 for the model with perceived benefits variable are showing that the perceived benefits variable is successfully demonstrating a full mediation role. This supports hypothesis 4 of this study.
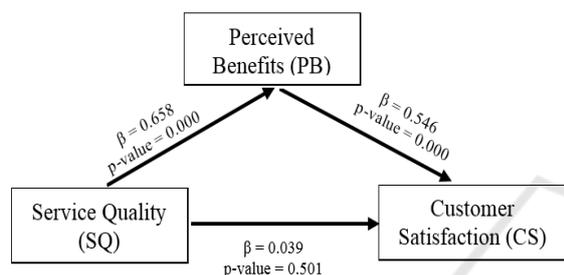

Figure 2: Testing the mediating role of PB.

5 CONCLUSIONS

With the increasing popularity of Islamic microfinance institutions (IMFIs) in Indonesia, many Muslim SME owners are moving from conventional MFIs to IMFIs. This study is aimed at examining the role of perceived benefits in mediating the relationship between service quality and customer satisfaction, in the case of Islamic microfinance institutions in Indonesia.

The findings have shown that SMEs owners' perceived benefits upon taking financing from IMFIs has had improved their satisfaction upon the IMFIs service quality performances. In other words, perceived benefits significantly mediating the relationship between service quality and customer satisfaction.

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