Why is Growth of Islamic Microfinance Lower than Conventional?
A Comparative Study of the Preferences and Perceptions of the Clients of Islamic and Conventional Microfinance Institutions' in Indonesia

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Whereas Indonesia has the largest Muslim country in the world with 88 % of 237 million population belonging to the faith, the growth of Islamic microfinance institutions (MFIs) has being sluggish and far behind their conventional counterparts. Islamic MFIs are struggling to survive amid the fierce competition in the provision of microfinance services, from both the conventional and Islamic. This paper will examine the factors determining the demand for microfinance services by reporting results from a survey of the perceptions and preferences of 581 MFI's borrowers from four MFIs—two Islamic (BMT and BPRS) and two conventional (BRI and BPR) in Indonesia. The results show that while the majority of MFI's clients indicates preference for Islamic MFIs, in reality their choices of MFI are based on economic (low interest rates and size of loan) and non-economic factors (such as quality of services variables easiness, speed, nearness, method and loan officers' profile). The results indicate that BRI, a conventional MFI, is ranked the most competitive according to these factors, followed by BPRS (Islamic rural banks), BPR (rural bank) and BMT (Baitul Maal wa Tamwil). The survey identifies the gaps that Islamic MFIs face to fulfill their positive roles and vehicles to reduce unemployment and poverty. As the MFIs clients prefer Islamic MFI compared to conventional, the demand for Islamic microfinance can be enhanced if the level of their economic and non-economic factors can be brought to the levels of conventional MFIs.

Key words: conventional MFI, Islamic MFIs, client's perceptions, preferences

1. Background

Indonesia is the largest country with 88% of the 237 million people belonging to the Muslim faith (based on 2010 Indonesian census) and the rest of religions are Protestants, Catholics, Hindus and Buddhists. The Indonesian banking institutions are categorized into commercial and rural banks. In Feb 2011, there were 122 commercial banks and 1822 rural banks. In the latter category, Islamic rural banks only 151 with 291 total bank offices. Compared to commercial banks, rural banks are not involved directly in payment system and have restricted operational areas.

Indonesia has the greatest diversity in both conventional and Islamic microfinance model. Islamic microfinance has developed in Indonesia since 1990. However, the growth of the Islamic MFIs is sluggish and far behind the conventional MFIs (see figure 1). This

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