



LEARNING FROM THE BANGLADESHI ISLAMIC MICROFINANCE MODEL FOR SHARIA MICROFINANCE DEVELOPMENT IN INDONESIA

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Abstract: The extreme institutional fragmentation of Indonesia's 4,500+ BMT units has led to an inability to achieve economies of scale despite serving 3.7 million customers with assets of Rp 16 trillion, while the Bangladesh centric bank model (RDS-IBBL) serves 520,000 members with high efficiency but at the expense of social closeness, creating a trade-off of efficiency versus embeddedness that requires systematic investigation. The research uses a comparative qualitative method by analyzing academic literature 2008-2025, institutional reports (UNDP, Bangladesh Bank, OJK, LAZ), and regulatory documents through comparative descriptive analysis of six dimensions with multi-source triangulation validity. Empirical findings show that the Bangladesh bank-centric model achieved a recovery rate of >95% and increased the income of 72% of participants, while the Indonesian community-based model had a recovery rate of 85-90% but was resilient during the 1997-1998 crisis, with a dominance of 70-80% in both countries, explained five factors: transaction cost economics, extreme information asymmetry, institutional path dependency, regulatory constraints, and customer preference for certainty. The theoretical contribution validates the path dependency theory that institutional design shaped by historical trajectories is different (the legacy of the Grameen Bank versus the tradition of mutual cooperation) and rejects the assumption of convergence by proving

persistent diversity that is context-dependent. The policy implications include five recommendations: a national apex body BMT for shared services while preserving local autonomy; Sharia Microfinance Academy with a target of 5,000 certified professionals in 5 years; harmonization of OJK regulations, Ministry of Cooperatives, Ministry of Religion; dual-track financing strategy to increase PLS proportion from <20% to 40% in 5 years; and the Structured Waqf Zakat Microfinance Integration Model Graduated Approach (70-80% Mustahiq to become muzakki in 2-3 years), requires a national coordination framework to transform the MFI ecosystem from atomistic fragmented to networked professionals to contribute optimally to the SDGs.

Keywords: Islamic Microfinance Institutions, Path Dependency, Shariah Financing Compliance, Social Finance Integration, Microfinance Performance

INTRODUCTION

Poverty and limited access to formal financial services remain major challenges for most low-income communities in developing countries, including Indonesia. Islamic microfinance institutions are present as an alternative solution that not only provides financial services based on Islamic principles, but also aims to empower the economies of small communities (Scott, 2012, p. 10). In Indonesia, Baitul Maal wat Tamwil (BMT) is a form of Islamic microfinance institution that plays a strategic role in the development of the people's economy, combining social functions (baitul maal) and business functions (baitul tamwil) in its operations (Rijal, 2020, pp. 140–150). However, the development of BMT in Indonesia still faces various obstacles, such as limited capital, low levels of institutional

sustainability, weak risk management, and suboptimal market penetration.

The group-based lending model developed by Grameen Bank in Bangladesh has proven effective in reducing poverty and empowering rural women through social capital development with shared responsibility mechanisms (Barua & Khaled, 2023, pp. 546–563). The success of the Grameen Bank model then inspired the birth of microfinance institutions in various countries, including in applications whose context is Islamic finance (Suseno, 2020, p. 3). Interestingly, Grameen Bank's principles such as group solidarity, women's empowerment, and focus on productive activities have philosophical similarities with Islamic finance, social justice, economic empowerment, and the rejection of the interest system (Bello et al., 2020, pp. 75–82). Bangladesh then developed an Islamic microfinance model through the Rural Development Scheme (RDS) operated by Islami Bank Bangladesh Limited (IBBL) since 1995. This bank-centric model serves 520,000 members with 94% women, achieves a high recovery rate, and is statistically proven to increase the income of 72% of participants (Parvej et al., 2020, pp. 111–124). UNDP recognizes RDS as *Best practice* with a high level of sustainability and transferability that other countries deserve to adopt (UNDP, 2012). Bangladesh also integrates cash waqf as a sustainable source of funding for the ultra poor segment (Samrat & Nabi, 2025, pp. 4496–4505), which shows innovation in bringing together the commercial and social dimensions of Islamic finance.

Although the literature on Islamic microfinance is quite rich, there are three critical gaps that have not been adequately addressed

and require systematic investigation. First, the comparative gap across countries: Previous studies have focused more on the Grameen Bank model in a global context or specifically in Bangladesh (R. Rahman & Nie, 2011, pp. 207–218), while research that directly links learnings from Bangladesh to the development needs of Indonesia's MFI is still very limited (Mamun et al., 2017, pp. 33–44). Barua & Khaled (2023) examine the transfer of the Grameen model to Global North (Barua & Khaled, 2023, pp. 546–563), but does not touch the context of Muslim countries with existing Islamic financial infrastructure such as Indonesia. Mamun et al. (2017) discuss Bangladesh's integrated approach to Islamic microfinance (Mamun et al., 2017, pp. 33–44), but did not conduct a comparative analysis with community-based models such as BMT Indonesia. Studies on BMT in Indonesia tend to be descriptive and evaluative of existing practices (Wediawati et al., 2018, pp. 1–14), without a systematic exploration of how Bangladeshi best practices can be adapted to Indonesia's local context (Purwanto et al., 2021, pp. 225–232). A fundamental question remains unanswered: What are the key elements of the Bangladesh model that causally contribute to its success, and how can these elements be transferred to the context of Indonesia which has a different institutional approach of bank centric (Bangladesh) versus community based (Indonesia)?

Second, gaps in understanding the structural barriers to adaptation: Existing literature identifies challenges faced by BMTs such as limited capital, low quality of human resources, and regulatory fragmentation (Septianingsih et al., 2024, pp. 19–26), but does not critically analyze why such barriers persist and how other countries with similar characteristics overcome them. Wediawati et al. (2018)

evaluate the sustainability of Indonesian Islamic microfinance (Wediawati et al., 2018, pp. 1–14), but does not offer international comparative learning-based solutions. Septianingsih et al. (2024) conducted a systematic review of BMT challenges (Septianingsih et al., 2024, pp. 19–26), but the recommendations given are generic without indicating *lesson learned* specific practices of other countries that have successfully addressed similar issues. Fundamental trade-offs have not been explored: How can Indonesia adopt the efficiency of Bangladesh's centralized model (economies of scale, standardization of procedures) without sacrificing the comparative advantages of a grassroots approach (social embeddedness, contextual flexibility) that proved resilient even during the 1997-1998 monetary crisis?

Third, gaps in Islamic social finance integration strategies: Although some studies have discussed the potential integration of zakat-waqf with microfinance (Hassan, 2014, pp. 333–357), there has been no research that has systematically compared how Bangladesh and Indonesia implement this integration, what are the causal mechanisms that make integration effective, and *lesson learned* what can be transferred. Hassan (2014) proposed a theoretical model of waqf-microfinance integration for poverty alleviation (Hassan, 2014), but its empirical implementation in Indonesia has not been evaluated comparatively with Bangladesh's more advanced practice of utilizing cash waqf as a sustainable source of funding (Samrat & Nabi, 2025, pp. 4496–4505). Masyita (2012) explores the demand factor of supply and the role of waqf for the sustainability of Indonesian MFIs (Scott, 2012a), but does not compare with Bangladesh's graduated approach model which has been proven to be empirically effective (Parvej et al.,

2020, p. 111). This gap is crucial because the integration of social finance is the key to the sustainability of MFIs in serving the ultra-poor segment that are not commercially bankable, as well as realizing maqasid al-sharia in alleviating structural poverty.

Based on a literature review, three structural problems prevent Indonesia's MFIs from reaching their optimal potential. First, extreme institutional fragmentation, thousands of BMTs operate atomistically without a peak body that provides shared services (IT platform, bulk funding, capacity building), resulting in high transaction costs and the inability to achieve economies of scale (Mawardi et al., 2020, pp. 235–249). Mawardi et al. (2020) even questioned whether Indonesia's MFIs need *Lender of Last Resort* Due to the difficulty of accessing cheap funding (Mawardi et al., 2020). Bangladesh addresses this through centralization in IBBL with standardization of procedures and access to bank deposits (M. M. Rahman et al., 2008, pp. 139–163), but similar solutions in Indonesia risk losing the advantage of BMT's proximity to local communities that proved resilient during the 1997-1998 crisis. Second, the deficit in human resource capacity with the scarcity of dual-competent professionals (operational microfinance + maqasid al-sharia). The implication is that the dominance of Murabaha instruments is 70-80% of the portfolio which is criticized as "covert usury" due to formalistic implementation without substantive risk sharing (Ascarya & Sakti, 2022, pp. 236–254). Nabi et al. (2017) show that Bangladesh faces a similar problem with Murabaha dominance indicating the limited capacity to implement advanced instruments such as Musharaka Mudaraba (Prophet et al., 2017, pp. 24–51). However, Bangladesh has a systematic training program from IBBL, while

Indonesia does not. Third, the fragmentation of BMT/KSPPS regulations is supervised by the Ministry of Cooperatives, SMEs (loose standards), BPRS by the OJK (strict standards), sharia aspects by DSN-MUI, creating regulatory arbitrage and trust deficits (Sugeng et al., 2024, pp. 89–122). Bangladesh also faces regulatory weaknesses as the Microcredit Regulatory Authority (MRA) does not have a specific framework for Islamic MFIs (Uddin & Mohiuddin, 2020, pp. 265–319), but the concentration on IBBL as a single operator reduces the complexity of multi-regulator coordination.

To fill the research gap and address these practical problems, this study explicitly answers three questions: First, a key element of Bangladesh's sharia microfinance model, particularly (a) a bank-centric RDS-IBBL institutional structure, (b) a group-based lending mechanism with sharia modifications, (c) a diversified portfolio of sharia financing instruments, and (d) the integration of waqf cash as a sustainable source of financing that is sustainable theoretically and empirically proven to be effective in achieving the normative goals of Islamic economics (distributive justice, economic empowerment, institutional sustainability), and how do the causal mechanisms of each element work to produce these outcomes?. Second, how key elements of the Bangladesh model can be adapted in the Indonesian context by considering structural differences in: (a) an institutional, bank-centric approach (efficiency, standardization) versus community based (embeddedness, flexibility); (b) unified regulatory framework under IBBL versus fragmented across the Ministry of Cooperatives, OJK, Ministry of Religion; (c) human resource capacity, systematic training of IBBL versus fragmentation of BMT training; and (d) level of

integration of Islamic social finance of structured cash waqf versus productive zakat which is still ad-hoc? What are the trade-offs that must be managed in the adaptation process (e.g.: efficiency vs embeddedness, standardization vs contextual flexibility)?. Third, what specific implementation challenges will arise in the process of adapting the Bangladeshi model to Indonesia including (a) institutional resistance to BMT consolidation, (b) political economy of multi-stakeholder coordination (OJK, Ministry of Cooperatives, Ministry of Religion), (c) capacity constraints for scaling up dual competency HR training, (d) regulatory uncertainty related to product innovation and digitalization and what concrete strategies are needed to overcome it obstacles so that Indonesian MFIs can contribute optimally.

This study has a novelty that fundamentally distinguishes it from previous studies: First, Conceptual Theoretical Novelty: This study is The first conducted a systematic comparative analysis between the Bangladesh and Indonesian community-based bank models using the framework *Institutional complementarities* and *Path Dependency Theory* to understand Why Model differences emerge and How Structural historical context influences transferability. In contrast to existing comparative studies that only compare "what's different" descriptively—for example, Barua & Khaled (2023) on the transfer of Grameen to Global North or Rahman & Nie (2011) on the synthesis of Gramee's approach (R. Rahman & Nie, 2011, p. 207) This study analyzes Structural Causality behind the differences and Contextual adaptation mechanisms required. This research also develops a framework Critical Comparative Analysis which does not assume the superiority of one model, but rather evaluates the trade-offs inherent in

each institutional design choice (efficiency vs embeddedness, standardization vs flexibility, centralization vs autonomy).

Next, this research produces policy actionable recommendations operational and based on comparative empirical evidence, not just normative aspiration. Recommendations include: (a) BMT peak body design that maintain local autonomy while achieving economies of scale through shared services (IT platform, bulk funding, training academy); (b) Hybrid model of digitalization who do not exclude the ultra poor segment by retaining field officers for social proximity; (c) Zakat-Waqf-Microfinance Integration Mechanism with a graduated approach based on *lesson learned* Bangladesh; (d) Harmonization of Multi-Stakeholder Regulations without over centralization through the OJK permanent coordination forum, Ministry of Cooperatives, Ministry of Religion. This is different from existing studies such as Septianingsih et al. (2024) which conducted a systematic review of BMT challenges (Septianingsih et al., 2024, pp. 19–26) or Ginanjar & Kassim (2021) on the role of BMT in financial inclusion (Ginanjar & Kassim, 2021, pp. 87–108) that identify problems without offering concrete implementation solutions based on comparative learning.

This study aims to: (1) Analyze comparatively the Bangladeshi sharia microfinance model (especially RDS-IBBL and cash waqf integration) with the practices of Indonesian MFIs (BMT, BPRS, sharia cooperatives) to identify the similarities, differences, advantages, and weaknesses of each; (2) Analyze the key elements of the Bangladeshi model that have the potential to adapt in the development of Indonesia's BMT by considering differences in

structural contexts; (3) Analyze the challenges and opportunities to adapt the Bangladesh model to Indonesia's socio-economic and regulatory context; (4) Formulate strategic recommendations for the development of Indonesian MFIs based on *lessons learned* from Bangladesh that are operational and implementable.

In practical terms, this research makes a distinctive contribution to various stakeholders: For regulators (OJK, Ministry of Cooperatives, Ministry of Religion), this study provides a blueprint for harmonization of comparative learning-based regulations to overcome fragmentation without eliminating the advantages of institutional pluralism. For practitioners (BMT/BPRS manager), this research offers operational guidance to improve efficiency through selective consolidation, Musharaka Mudaraba-based product development, and inclusive adoption of hybrid technology. For Islamic social finance institutions (BAZNAS, nazhir waqf, LAZ), this study shows a productive integration mechanism with microfinance based on Bangladesh's graduated approach which has been proven to be effective in converting 72% of the ultra poor into an economy Productive (Parvej et al., 2020, p. 111). For academics, this research opens a further research agenda on institutional adaptation in comparative Islamic finance, contribution to the SDGs through sharia mechanisms, and evaluation of the long-term impact of social commercial integration models. In addition, this research is expected to be a catalyst for international collaboration in the development of Islamic microfinance, especially between Indonesia and Bangladesh to accelerate the achievement of the SDGs, especially poverty alleviation and community economic empowerment.

METHODS

This study uses a qualitative method with a comparative study approach (*Comparative case study*) to analyze the learning of Bangladesh's sharia microfinance model that can be adapted in the development of Indonesian MFIs (Creswell & Creswell, 2018). This method was chosen for three reasons: first, it allows for the analysis of *Trade Offs* Institutional (efficiency vs *embeddedness*) that cannot be answered by a single case study; second, secondary data provides *thick description* without *Field Research* intensive; Third, multi-source triangulation ensures comparative validity (Michael Quinn Patton, 2022). The primary analysis unit is the institutional model of Islamic microfinance: IBBL Bangladesh's Rural Development Scheme (RDS) as a bank-centric model versus BMT, BPRS, Indonesian Sharia Cooperatives as a community-centric model. The secondary analysis unit includes six dimensions: (1) institutional structure; (2) portfolio of financing instruments; (3) Mechanism *Group Based Lending*; (4) integration of Islamic social finance; (5) measurable socio-economic impact; and (6) structural challenges (Yin, 2018).

Secondary data was collected from three sources (Seibel, 2014). First, an internationally indexed journal (Scopus, Web of Science, Google Scholar) for the period 2008-2025 on Islamic microfinance in Bangladesh and Indonesia. Second, institutional reports: Bangladesh Bank, UNDP (2012), OJK Sharia Banking Statistics (2024), and LAZ reports (BAZNAS, LAZISMU, Dompot Dhuafa), as well as publications by the Ministry of Religious Affairs of the Republic of Indonesia (2024) related to LAZ regulations. Third, regulatory

documents: Bangladesh's MRA guidelines, Law No. 21/2008 on Islamic banking, POJK No. 7 & 23/2024, Ministerial Regulation on Cooperatives No. 16/2015, and Regulation on Religion No. 19/2024. Selection criteria: English/Indonesian publications, focus on Islamic microfinance practices, and availability of empirical data on institutional structure or socioeconomic impact.

Data analysis using *Comparative descriptive analysis* (Miles & Huberman, 1994; Patton, 2022) with three stages (Matthew & Michael Huberman, 1994): (1) Data reduction: extraction of relevant information from the literature and categorization based on six dimensions; (2) Data presentation: comparative matrix of Bangladesh vs Indonesia, quantitative table (*recovery rate* >95% RDS vs 85-90% BMT; Proportions *Murabaha* 70-80%; 72% revenue impact with $P < 0.000$ for RDS), and contextual narrative; (3) Interpretation: analysis *Trade- FFS*, identify the element *transferable*, and formulation of strategic recommendations by considering adaptation barriers (institutional resistance, multi-stakeholder coordination, human resource capacity). Aspects compared: institutional structure, financing portfolio, target market (94% RDS women vs 70-80% BMT), social finance integration (structured cash waqf vs ad-hoc productive zakat), and SDGs contribution (SDGs 1, 5, 8). Validity is ascertained through triangulation of sources: academic literature (*Peer-reviewed*) for theoretical validity, institutional reports for empirical validity, and regulatory documents for legal-institutional validity, with *cross-verification* Independent Sources (Denzin, 2012, pp. 80–88) .

RESULT AND DISCUSSION

Bangladesh Islamic Microfinance Model

Bank-centric approach: Bangladesh developed an Islamic microfinance model through the Rural Development Scheme (RDS) operated by Islami Bank Bangladesh Limited (IBBL) since 1995 in response to the needs of poor rural Muslims who are unable to access conventional financing due to the prohibition of usury (M. M. Rahman et al., 2008, pp. 139–163). The RDS has grown from a four-village pilot project to a national program serving 520,000 members with a 94% female composition, demonstrating the high scalability of the bank-centric model in the context of Islamic microfinance (M. M. Rahman et al., 2008). UNDP recognizes RDS as *Best practice* with sustainability and *transferability* high that is worthy of adoption by other countries, indicating that formal banking institutions can be effective in Islamic microfinance with the right program design (UNDP, 2012).

RDS's portfolio of financing instruments is diversified: Bai Murabaha (margin buying and selling), Bai Muajjal (deferred payments), Musharaka (profit-sharing partnership), Mudaraba (profit-sharing), Ijarah (leasing), and Qard Hassan (non-margin charitable loans) (Islam, 2015, pp. 562–570). These instruments finance the agricultural sectors (seeds, fertilizers, irrigation), small trade, household manufacturing, and rural transportation, demonstrating the flexibility of RDS to adapt to local economic needs. RDS adopts the methodology *Group Based Lending* adaptation of Grameen Bank with sharia modifications: customers are organized in groups of 5-10 people with a system of shared responsibility (*joint liability*), social solidarity

is built on *ukhuwah islamiyah* and *Trust* in lieu of physical security, producing *recovery rate* >95% (M. M. Rahman et al., 2008).

Measurable socioeconomic impact: A study of 328 RDS borrowers showed that 72% of respondents experienced a significant increase in income ($P < 0,000$), proving the empirical effectiveness of Islamic microfinance in transforming the economy of poor households (Parvej et al., 2020, pp. 111–124). Women's empowerment is significant with 94% of female members experiencing increased family economic control, strengthening decision-making bargaining positions, and developing entrepreneurial skills, contributing to SDG 5 (Gender Equality) and SDG 1 (No Poverty) (Shahbub Alam et al., 2022, pp. 1–13). The latest innovation is the integration of waqf cash as a sustainable source of funding: the principal of waqf is maintained eternally, the investment returns for ultra poor microfinance with low costs/qard hassan, make it possible to *Graduate Approach* (Samrat & Prophet, 2025, p. 4496).

Structural challenges: Market penetration is only 5% despite 90% of the Muslim population due to low public awareness, limited vs conventional Islamic MFIs (Grameen Bank, BRAC) networks, complex perception of sharia products, and limited capital (Prophet et al., 2017). **Weak regulatory framework:** The Microcredit Regulatory Authority (MRA) does not have a specific framework for Islamic MFIs, regulates all MFIs to uniform standards without considering sharia characteristics, causes difficulties in product innovation and there is no mandatory sharia audit mechanism (Uddin & Mohiuddin, 2020, pp. 265–319). **Limited human resource capacity:** the majority of field officers are conventional practitioners with short sharia training

without in-depth understanding *Maqasid al-Shariah* and *Fiqh Muamalat*, resulting in Murabaha's dominance of 70-80% which was criticized as "interest in disguise" (Prophet et al., 2017, pp. 42–45).

Islamic Microfinance Model in Indonesia

Bank Centric Approach: Indonesia develops a community-based Islamic microfinance ecosystem through three pillars: Baitul Maal wat Tamwil (BMT), Sharia People's Financing Bank (BPRS), and Sharia Cooperatives (Seibel, 2014, pp. 15–25). Data for 2024 shows >4,500 units of BMT with cumulative assets of IDR 16 trillion serving 3.7 million customers, while 157 BPRS operate formally with strict banking standards under the supervision of the OJK (Septianingsih et al., 2024, pp. 19–26). BMT has a unique *Dual Function*: Baitul Maal (zakat-waqf-infaq manager for the ultra-poor) and Baitul Tamwil (sharia productive financing for micro-enterprises), making it a typical Indonesian innovation not found in Bangladesh (Suseno, 2020).

The portfolio of financing instruments shows a similar pattern to Bangladesh: Murabaha dominance 70-80%, with Musharaka, Mudaraba, Ijarah, Qard Hassan <20% (Septianingsih et al., 2024, pp. 19–26). Field studies show the financing contribution of the agricultural sector is minimal (<5%) vs trade-manufacturing, indicating a bias towards the sector *Bankable* (Fitriana, 2016, pp. 149–162). Target market: MSMEs, market traders, smallholders, household industry craftsmen, with 70-80% female customers (Ginanjari & Kassim, 2021, pp. 87–108). Empirical studies prove that MFI financing programs have a positive impact: increased working capital, product diversification, market expansion, and significant increase in

household income, although quantitative data are not as comprehensive as Bangladesh's (Gina & Effendi, 2015, pp. 34–43).

Innovation in social financial integration: 170 official LAZ (45 national, 39 provinces, 86 districts/cities) as of February 2024 with new regulations (Permen of Religion No. 19/2024) simplifying licensing and tightening amil certification (Ministry of Religion of the Republic of Indonesia, 2024). LAZ (LAZISMU, Dompot Dhuafa, BAZNAS) developed a microfinance integrated productive zakat program with a success rate of 70-80% mustahiq to become muzakki in 2-3 years, proving its effectiveness *Graduate Approach* (Lazismu, 2023). Hybrid digitalization: The 2022 study proposes a micro-fintech model using the Analytic Network Process (ANP) for BMT's digital platform with operational efficiency, reaching remote areas (mobile banking, agent banking, sharia digital wallets), and blockchain exploration for zakat-waqf transparency (Ascarya & Sakti, 2022, pp. 236–254).

Complex structural challenges: (1) Institutional fragmentation, thousands of atomistic BMTs without an apex body providing shared services, resulting in high transaction costs and inability economies of scale (Mawardi et al., 2020, pp. 235–249); (2) Deficit in human resource capacity, scarcity of dual competency professionals (operational microfinance + maqasid al-shariah), resulting in formalistic sharia implementation (Septianingsih et al., 2024); (3) Regulatory fragmentation, BMT/KSPPS supervised by the Ministry of Cooperatives (loose standards), BPRS by OJK (strict standards), sharia aspects of DSN-MUI, creating regulatory arbitrage and trust deficits (Sugeng et al., 2024, pp. 89–122); (4) Islamic financial literacy is low,

people do not understand the substantial difference between Islamic vs conventional products (Septianingsih et al., 2024); (5) Technology adoption lagging, the majority of manual/semi-digital system BMT is inefficient (Ascarya & Sakti, 2022); (6) High operating cost burden, serving the bottom segment with small financing value in dispersed remote locations (Septianingsih et al., 2024).

Comparison of Bangladesh Vs Indonesia

Table 1. Comparison of Bangladesh and Indonesia

Dimensions	Bangladesh (RDS-IBBL)	Indonesia (BMT-BPRS)
Institutional Model	Centralized central banks	Fragmented centric communities
Number of Members	520,000 (single operator)	3.7 million (4,500+ BMT units)
Proportion of Women	94%	70-80%
Recovery Rate	>95%	85-90% (estimate)
Murabaha Dominance	70-80%	70-80%
Musharaka-Mudarabah	~20%	<20%
Revenue Impact	72% significant increase (P<0,000)	Limited data, positive qualitative
Social Finance Integration	IBBL structured cash waqf	170 LAZ, ad-hoc productive zakat
Market Penetration	5% (vs 95% conventional)	Limited data, suboptimal range
Regulation	MRA uniform (non-shariah-specific)	Multi-regulator fragmented (OJK-Ministry

		of Cooperatives-Ministry of Religion)
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Source: Data Processing Observation

Results of the Discussion

Why Do Institutional Model Differences Arise? Path Dependency and Institutional Complementarities

The fundamental difference between the institutional structure of Bangladesh's central bank vs Indonesia's centric community reflects *path dependency* historical and *Institutional complementarities* different (North, 1990). Bangladesh adopted the IBBL centralized model because of four causal factors: (a) *Legacy Grameen Bank* (1983) proved the effectiveness of formal institutions in microfinance, creating *Institutional Template* adapted to Islamic banking; (b) *Government policy support* Islamic banking since the 1980s as an alternative to the conventional system, providing *enabling environment* for IBBL as a first mover (Karim et al., t.t.); (c) *High population density* in rural Bangladesh allows *economies of scale* serving 520,000 members with an efficient branch network structure; (d) *Institutional capacity IBBL* As the largest Islamic bank with strong capital, professional management, and uniform nationwide operational standards (UNDP, 2012).

In contrast, Indonesia developed a grassroots approach because: (a) *The Tradition of Mutual Cooperation* and the people's economy is firmly entrenched, creating cultural embeddedness for community-based institutions (Bowen, 1986); (b) *Geographic fragmentation*, thousands of islands need local institutions that *embedded* with *Social*

Capital to overcome information asymmetry and moral hazard (Ostrom, 1990, pp. 92–104); (c) *Islamic economic movement* since the 1990s have been bottom-up grassroots, not top-down government driven like Bangladesh (Suseno, 2020); (d) *Banking exclusion* The limited reach of formal banks to remote villages creates space for BMT to fill the gap (Seibel, 2014).

The trade-offs faced reflect *efficiency vs embeddedness dilemma* Documented Development Economics Literature (Evans, 1996): Bangladesh wins *operational efficiency* (low cost per financing unit, recovery rate >95%, standardization of procedures) but at the expense of *Social Proximity* members do not have *Ownership* and limited participation in financial transactions (UNDP, 2012). Indonesia maintains *Social Embeddedness* (BMT is deeply rooted in the community, members have a voice and agency) but bear the burden *High operational costs* and fragmentation hampers economies of scale (Mawardi et al., 2020). Paradoxically, Indonesia's centrist community model is proven to be *Resilient* During the 1997-1998 monetary crisis, due to customer loyalty and the Islamic system, the risk of exchange rates destroying conventional banking (Suseno, 2020), validates Ostrom's argument that *Common Pool Resource Institutions* community-based more sustainable in the context of external volatility (Ostrom, 1990).

Why the Dominance of Murabaha in Both Countries? The Gap Between Sharia Idealism and Operational Reality

Contract dominance *Murabaha* 70-80% in Bangladesh and Indonesia express *Systemic Gap* between the idealism of Islamic economics (risk-sharing partnerships) and operational reality (debt like

transactions) (El-Gamal, 2006). Islamic economics literature criticizes *Murabaha* as "interest in disguise" because the margin remains without genuine risk sharing (Khan, 2013), but persistent dominance due to five causal factors:

First, *Transaction Cost Economics: Murabaha* has much lower monitoring costs than *São Paulo* and *mudarabah*. In *Murabaha*, the bank buys assets and sells them to customers on a fixed margin, the risk is limited to default payment. In *Musyarakah Mudarabah*, institutions must monitor business performance continuously, verifying vulnerable profit loss reports *underreporting* (moral hazard), and has expertise in evaluating business viability (Aggarwal & Yousef, 2000, p. 93). Aggarwal & Yousef (2000) study shows that cost monitoring *profit-loss sharing* 3-5x higher than debt-like contracts (Aggarwal & Yousef, 2000, p. 93). For MFIs serving thousands of micro customers with small financing values, PLS monitoring costs are prohibitively expensive.

Second, *Information asymmetry* The ultra poor and informal micro business segments have characteristics: no bookkeeping, highly volatile revenues, simple business model without separation ownership management (Armendáriz de Aghion & Morduch, 2007). In these conditions, *Adverse selection* (institutions cannot distinguish high risk vs low risk borrowers) and *Moral hazard* (borrowers incentive to misreport profits) makes PLS instruments highly risky. Bangladesh and Indonesia are trying to mitigate through *Group Lending* with *Peer Monitoring* (Ghatak & Guinnane, 1999, p. 195), but effectiveness is limited when business outcomes are genuinely unpredictable

(agricultural sector exposed to weather shocks, petty trade exposed to daily demand fluctuations).

Third, *Institutional path dependency*: The majority of Islamic MFIs field officers are conventional practitioners of microfinance with short sharia training, do not have a deep understanding *Maqasid al-Shariah* and *Fiqh Muamalat* (Prophet et al., 2017). IBBL Bangladesh's systematic training is better than the fragmentation of BMT Indonesia's training, but both have not been able to build *Dual competency* (operational microfinance + Islamic finance principles) en masse (Uddin & Mohiuddin, 2020). As a result, the implementation of PLS instruments is shallow *São Paulo* often executed as *Murabaha* disguised (fixed margin without genuine profit sharing), fails to reflect the substance of the Islamic economy.

Fourth, *Regulatory Constraints*: MRA Bangladesh and OJK Indonesia do not have *Prudential Standards* specific to PLS instruments (Uddin & Mohiuddin, 2020). Capital adequacy requirements, provisioning rules, and risk weighting are the same for all financing types, not reflecting inherent differences between debt like (murabaha) and equity like (musharakah and mudarabah) contracts. This creates *Regulatory disincentive* for more institutional PLS *Risk averse* Choosing Murabaha because it is easier to comply with prudential regulations (Archer & Karim, 2009).

Fifth, *Customer Preferences*: Study shows micro customers prefer *Certainty* in payment obligations (Karlan & Zinman, 2008, p. 1040). *Murabaha* With fixed installments, cash flow is easier to understand and plan than *São Paulo* with variable profit sharing that depends on business performance. Paradoxically, although PLS is

normatively more "Islamic" (genuine risk sharing), in practice customers themselves prefer debt-like certainty because it reduces *Planning Complexity* and *Behavioral Anxiety* Related to Variable Bonds (Hassan & Lewis, 2007, pp. 115–130).

Why is Islamic Social Finance Integration Different? Structured vs Ad-Hoc Model

Bangladesh develops *Cash Waqf Integration* structured through IBBL: waqf fund invested in sharia compliant instruments, returns used *Qard Hassan* for ultra-poor with *Graduate Approach* (QARD Hassan → Commercial Financing Post Bankability) (Samrat & Prophet, 2025, p. 4496). This model has three advantages: (a) *Perpetual funding source*, waqf principal preserved forever, only returns used, ensuring sustainability; (b) *Zero-cost capital* for the ultra poor segment that is not commercially bankable, allowing MFIs to serve bottom of the pyramid without sacrificing financial sustainability (Decree of the Chairman of the Capital Market Supervisory Agency and Financial Institutions Number: Kep-430/BL/2012 concerning Contracts Used in the Issuance of Sharia Securities in the Capital Market, 2012); (c) *Aligned incentives* IBBL as a single operator can internalize positive externalities (ultra poor who graduated to commercial clients), creating virtuous cycle (Samrat & Prophet, 2025, p. 4496).

Indonesia shows progress through 170 official LAZ with a productive zakat program reaching 70-80% of mustahiq to become muzakki in 2-3 years (Lazismu, 2023). However, integration is still *Ad-hoc* Because: (a) *Institutional fragmentation*, LAZ operates independently without systemic coordination with BMT BPRS, causing duplication efforts and missed synergies (Masyita, 2012b, pp.

145–162); (b) *Regulatory constraints*, Waqf Law No. 41/2004 has not been fully operationalized for productive waqf, creating legal uncertainty for innovative waqf-microfinance integration (Law of the Republic of Indonesia Number 41 of 2004 concerning Waqf, t.t.); (c) *Nazir capacity limitations*, the majority of traditional nazirs without financial management skills to manage waqf funds productively with prudent investment and transparent reporting (Scott, 2012b).

Why do differences appear? *Institutional centralization* Bangladesh (IBBL as the dominant player) facilitates coordination, standardization, and internalization of externalities that are difficult for Indonesia to achieve with a fragmented ecosystem (Coase, 1937, p. 386). This validates Coase's argument about *transaction costs* and firm boundaries: when coordination costs are high (Indonesia), activities remain atomistic; when a single entity can internalize externalities with lower coordination cost (Bangladesh), integration occurs (Coase, 1937).

BMT Indonesia dual model (*Baitul Maal + Baitul Tamwil* in one institution) actually *Innovative* conceptually, linking social assistance with productive financing in an integrated system, is superior to Bangladesh which separates charities (NGOs) and commercial microfinance (IBBL) (Suseno, 2020, pp. 10–12). However, the implementation *Suboptimal* because individual BMT is too small to achieve scale, lack of professional management to balance social commercial objectives, and regulatory ambiguity (supervised by the Ministry of Cooperatives, not OJK) creates a trust deficit (Septianingsih et al., 2024, pp. 19–26).

Theoretical learning: Islamic social-commercial financial integration requires *Institutional Architecture* The Balance: (a) *Coordination mechanisms* (apex body, shared platform) to overcome fragmentation without over centralization that kills local embeddedness; (b) *Regulatory clarity* for productive waqf zakat with prudential standards but flexibility for innovation; (c) *Capacity building* Nazir Amil in Financial Management, Impact Measurement, and Transparent Reporting for Build Public Trust; (d) *Hybrid models* that combines centralized funding (scale efficiency) with decentralized delivery (community embeddedness), for example, LAZ national partnership with local BMT for productive zakat channels with standardized procedures but contextual adaptation (Hassan, 2014, pp. 350–355).

Implications for Theories of Institutional Economics and Islamic Finance

A comparison of Bangladesh and Indonesia offers three theoretical contributions: First, *path dependency* and *Institutional complementarities*: The institutional model is not just a "rational choice" but shaped by historical trajectories and interlocking institutions (North, 1990, pp. 92–104). Bangladesh's bank-centric model is complementary with: centralized regulatory structure (MRA), government policy actively promoting Islamic banking, and cultural acceptance of formal institutions given Grameen Bank's legacy (UNDP, 2012, p. 20). Indonesia's community centric model complementary with: decentralized governance (provincial-district autonomy), cultural tradition of gotong royong, and historical resilience during 1997-1998 crisis validating community-based

approaches (Suseno, 2020, pp. 8–10). This validates North's argument that institutional change is path-dependent small events (Grameen Bank success 1983, BMT resilience 1997-1998) can create self-reinforcing patterns that are difficult to reverse (North, 1990, pp. 98–103).

Second, *Trade Offs* in institutional design: There is no "optimal model" universally every design choice involves trade offs (Evans, 1996, p. 1119). Bank-centric model (Bangladesh) achieves operational efficiency and standardization but sacrifices social embeddedness and community ownership (M. M. Rahman et al., 2008, p. 139). Community centric model (Indonesia) maintains social capital and local adaptation but faces fragmentation and inability to achieve scale (Mawardi et al., 2020, pp. 244–247). The microfinance literature often assumes convergence toward "best practice" (usually the Grameen inspired model) (Morduch, 1999, p. 1569), but this study shows *persistent diversity* reflecting different institutional equilibria, neither superior in absolute terms, comparative advantage context dependent (Ostrom, 1990, pp. 88–102).

Third, *Gap between Ideal Standards and Institutional realities* in Islamic finance: The dominance of murabaha reveals the tension between equity-based ideals (*São Paulo* and *mudarabah*) and debt based realities. This is not just a "failure" but *rational adaptation* on transaction costs, information asymmetries, and regulatory environments (El-Gamal, 2006, pp. 85–95). Implicitly, the development of Islamic finance must move beyond normative prescriptions ("Islamic finance should be equity-based") toward *Institutional Analysis* Understanding *why* certain practices emerge and

how to design institutions facilitating closer alignment between ideals and realities (Kuran, 2010, pp. 125–145).

Strategic Learning for Indonesia: Evidence-Based Recommendations

Based on comparative analysis, five strategic learnings for Indonesia: First, *Hybrid Institutional Architecture*: Shape National BMT Apex Body which provides shared services (IT platform, wholesale funding, training academy) while preserving local autonomy of BMT (Woolcock & Narayan, 2000, pp. 225–249). This model of balance efficiency (Bangladesh) and embeddedness (Indonesia) is not full centralization (risk of killing social capital) or status quo fragmentation (risk of perpetual inefficiency), but *networked governance* where BMT retains operational independence while accessing economies of scale through the apex body (Ostrom, 1990, pp. 1128–1130).

Second, *dual-competency HR development*: Establish Sharia Microfinance Academy with curriculum integrate: (a) Microfinance operations (credit assessment, portfolio management, risk management); (b) Islamic finance principles (*Maqasid al-Shariah, Fiqh Muamalat*); (c) Social entrepreneurship for balance commercial social objectives (Sugeng et al., 2024, pp. 110–115). The apprenticeship model with rotation between classroom learning and field placement at BMT, BPRS proved effective.

Third, *Regulatory harmonization* without over-centralization: Permanent coordination forum of OJK, Ministry of Cooperatives, Ministry of Religion with division of labor: OJK handle prudential supervision (financial soundness), Ministry of Cooperatives handle

operational aspects (business model, governance), Ministry of Religion handles shariah compliance through DSN-MUI (Sugeng et al., 2024, pp. 115–120). This avoids regulatory arbitrage while respecting institutional pluralism (Uddin & Mohiuddin, 2020, p. 265).

Fourth, *Dual-Track Financing Strategy*: (a) Continue *Murabaha* for financing predictable activities; (b) Scale up *musyarakah-mudarabah* For genuinely entrepreneurial ventures with intensive mentoring, staged financing, and digital monitoring reduce transaction costs (Ascarya & Sakti, 2022, pp. 248–252). Target: increase PLS proportion from <20% to 40% in 5 years. Fifth, *Structured waqf-zakat-microfinance integration*: LAZ national partnership with local BMT for graduated approach (ultra poor → qard hassan from waqf zakat → commercial financing post-bankability), combine centralized funding (scale efficiency) with decentralized delivery (community embeddedness) (Hassan, 2014, pp. 352–357). Require regulatory reform (operationalize Waqf Law No. 41/2004 for productive waqf) and nazir professionalization (mandatory certification) (Masyita, 2012b, pp. 178–185).

CONCLUSION

These comparative studies resulted in significant theoretical and practical contributions. Theoretically, the research validates the path dependency theory by proving that the institutional design of Bangladesh (bank centric) and Indonesia (community based) shaped by historical trajectories is different, the legacy of Grameen Bank versus the tradition of mutual cooperation and resilience of the 1997-1998 crisis which created a trade off efficiency versus embeddedness where

Bangladesh achieved a recovery rate of $>95\%$ with high operational efficiency but at the expense of social proximity. while Indonesia maintains community embeddedness but faces fragmentation with a recovery rate of 85-90%. The study rejects the assumption of convergence toward a single "best practice" by proving persistent context-dependent diversity, and reveals the dominance of murabaha of 70-80% in both countries as a rational adaptation to five structural factors: transaction cost economics (monitoring cost PLS 3-5x debt-like contracts), extreme information asymmetry, institutional path dependency, regulatory constraints, and customer preference for certainty. Practically, the research produced five evidence-based recommendations: the establishment of a National BMT Apex Body for shared services while preserving local autonomy, the establishment of the Sharia Microfinance Academy with a target of 5,000 certified professionals in 5 years, regulatory harmonization through the permanent coordination forum of the OJK, the Ministry of Cooperatives, the Ministry of Religion, and the dual track financing strategy to increase the PLS proportion from $<20\%$ to 40% in 5 years, and Structured Waqf Zakat Microfinance Integration Model Graduated Approach.

The limitations of the research include reliance on secondary data that limits the depth understanding of micro level dynamics, comparative case studies of only two countries that limit generalizability, and the absence of quantitative impact evaluation using rigorous methods, opening up the advanced research agenda including: development of formal models efficiency embeddedness trade off, rigorous impact evaluation experimental/quasi experimental

designs comparing PLS vs murabaha, longitudinal studies tracking BMT 5-10 year clients, pilot programs testing recommendations, regulatory sandbox for Islamic fintech, development monitoring evaluation national framework, and establishment research practice consortium. The overall implementation of the recommendations requires a national coordination framework involving the government, regulators, industry associations, academics, and civil society with crucial political will to transform Indonesia's MFI ecosystem from atomistic fragmented to networked professionals who balance efficiency, embeddedness, commercial sustainability, social mission, and shariah compliance operational excellence to optimally contribute to the SDGs, especially poverty alleviation and Economic empowerment aligns with maqasid al-Shariah.

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