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Asymmetric information issues in micro-business financing of Baitul Maal wa Tamwil

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Abstract

Purpose – Despite its potential advantages, poverty interferes with economic progress in developing countries, obstructing small and medium-sized businesses from obtaining external financial assistance via Islamic microfinance. This study explores the problems related to asymmetric information in the context of funding microbusinesses in Baitul Maal wa Tamwil (BMT), with the goal of improving our understanding of the risks associated with financing in Islamic microfinance institutions, namely BMTs.

Methodology – This research utilized a qualitative approach and content analysis to study BMTs in Indonesia, involving academics, practitioners, and voluntary participants. The sample size was adequate for achieving data saturation.

Finding – This study demonstrates that there might be asymmetric information during the execution of contracts, leading to deviant behavior by BMT management and partners. The study additionally identified the risk characteristics present in Islamic MFIs, emphasizing the necessity for implementing novel lending mechanisms, such as group lending and individual collateralized loans.

Implication – This study underscores the importance of resolving the substantial administrative overheads associated with these institutions. It is advisable to utilize additional research methods such as interviews, observations, and documentation to augment the depth of the research and engage a varied array of individuals for a comprehensive collection of information.

Originality – Studies of Islamic microfinance in Indonesia have examined its performance, obstacles, and experience. However, empirical data on agency problems such as moral hazard and asymmetric knowledge are lacking. For optimal BMT operating efficiency and Shariah compliance, it is essential to comprehend these challenges.

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Introduction

Poverty has become a significant obstacle to economic progress, particularly in developing nations. Small- and medium-sized enterprises (SMEs) are highly recognized as effective catalysts for innovation, productivity, and vitality, providing significant advantages to various economic sectors by generating employment opportunities, fostering production advancements, promoting exports, and driving national revenue growth, especially in low-income nations. Poverty has become a significant obstacle to economic progress, particularly in developing nations. Small- and medium-

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sized enterprises (SMEs) are highly esteemed for their ability to foster innovation, enhance productivity, and exhibit dynamism. They positively impact various economic sectors by generating employment opportunities, promoting production advancements, encouraging export-oriented activities, and contributing to national revenue growth. This is particularly significant in low-income countries (Motta, 2020; Olivera, 2018). However, in many developed and developing countries, SMEs must obtain external funding in the early and middle stages of their entrepreneurial life cycle. Capital lenders' moral hazard in the presence of asymmetric information is one of the major factors preventing small and medium-sized businesses from obtaining finance (Liu, 2017). A more detailed explanation regarding this issue is that a lack of funds is one of the main factors influencing the healthy development of small and micro enterprises and the reason for the tendency for incorrect and asymmetric financial information to occur with financing applications. In this case, if the lender is not aware of it, moral hazard can occur.

To obtain financing, small and medium enterprises must have sufficient capital as collateral. Inadequate information, poor counsel, collateral requirements, transaction costs, loan amounts, interest rates, payment terms, loan maturity, and lending methods are among the main investor limitations (Thaker et al., 2020; Motta, 2020). While small businesses represent a small proportion of overall SME loans, micro enterprises (MEs) lag significantly behind the formal banking system because of high transaction costs and a lack of a comprehensive monitoring mechanism (Muneer, 2018). For example, micro-enterprises in Bangladesh have more severe credit constraints than larger enterprises, with most of their business capital coming from entrepreneurs' personal money. On the other hand, MFI's belief that micro-enterprises do not generate substantial returns makes micro-enterprise financing difficult.

Poor people need small-scale services that take little time to offer compared to the expense of processing them (Ssembajjwe, 2021). They were unable to provide deposits or collateral to receive loans. Islamic microfinance was created to fill the gap left by conventional microfinance in Muslim nations (Yusuf, 2019). Its mission is to provide Sharia-compliant loans to impoverished businesses that have been left out of the conventional capital market supplied by the banking industry. Islamic microfinance institutions encourage the formation and expansion of businesses, consequently developing human capital and increasing the consumption of other products and services. When it comes to small businesses in underdeveloped nations, adverse selection and moral hazard become more problematic. Physical impediments prevent financial organizations from acquiring the necessary information about potential clients, and when loans are made, it is difficult to monitor how the funds are utilized (Yusuf, 2019).

Many contracts in accordance with Sharia principles have the potential to be used by microfinance institutions. However, more effort is required to implement these contracts. For example, Musharaka contract financing requires transparency for both parties, namely Islamic banks as owners of capital and business managers (Aminudin, 2020). Aminudin (2020) also explains that agency problems carried out by agents in financial contracts are in the form of moral hazard and adverse selection. Adverse selection occurs when the borrower has poor quality external credit, and it is possible that the customer will use the funds given inappropriately. BMT has proven to be beneficial in decreasing poverty in Indonesia by providing poor people with loans. However, BMT, which is an institution providing funds, one of which is for micro-entrepreneurs, faces several problems, namely, related to asymmetric information. Research conducted by Wulandari and Kassim (2016) recommends that the BMT provide credit-plus finance, which includes not only funding, but also infrastructure construction and maintenance, as well as routine training and religious activities for borrowers. Many researchers have discussed the experiences, challenges, roles, and performance of Islamic microfinance (Riwajanti, 2014; Nazirwan, 2015; Wulandari & Kassim, 2016; Effendi, 2017; Febianto et al., 2019; Husaeni & Dew, 2019). Nevertheless, empirical evidence focusing on agency problems, including asymmetric information and moral hazard issues faced in microenterprise financing through this institution, is still lacking. Because of this issue of Shariah compliance with BMT operational efficiency, a complex, thorough understanding of the issues is needed. It is believed that there seems to be a literary gap in this case study. This study identifies issues related to asymmetric information on microbusiness financing in BMT. This study is expected to enrich intellectual treasures related to the risk of financing in Islamic microfinance institutions, especially BMT.

Literature Review

Asymmetric information in Microfinance

According to the theory of asymmetric information, "risk" and "coverage" should have a positive association that is both predictable and strong (Su & Spindler, 2013). Su and Spindler (2013) explain that while adverse selection concerns "hidden information, "moral hazard deals with "hidden action." Predicted loss in the empirical literature makes it unquestionably difficult to separate moral hazard from adverse selection. Even though both phenomena result in a positive correlation between risk and coverage, there is one clear differentiation: in the case of an insurance contract, adverse selection is the risk of the potential insured person influencing the contract choice, whereas in moral hazard, the contract is chosen and then influences the behavior, which affects the coverage. In principle, asymmetric information has a significant impact on credit markets, resulting in inefficient low loan provisions and even market unwinding (Akerlof, 1970). In credit markets, imperfect information can lead to excess supply equilibria, where banks offer lower interest rates to good credit risk customers, resulting in no bank lowering its interest rate (Stiglitz & Weiss, 1981). In this case, a lender may opt not to lend money even though the borrower has the potential to make loan repayments on time because he lacks sufficient information on the borrower.

Creditworthiness and trustworthiness are nearly synonymous because, in the presence of asymmetric information, the act of granting a loan has the indirect consequence of indicating the borrower's trustworthiness (Becchetti & Conzo, 2011). Furthermore, Becchetti and Conzo (2011) argue that the microfinance screening process contributes to the production of a public good such as information by giving signals to potential business partners who have asymmetric information on the borrower. This, in turn, given the specific characteristics of trust games, enhances trust and trustworthiness with positive effects on the outcome produced in investment games. Loan concession is an indication of creditworthiness, which denotes trustworthiness (Becchetti & Conzo, 2011). If most business partnerships are investment games, trustworthiness may boost the borrower's business success considerably. The microfinance concession influences itself, which may boost the likelihood of successful repayment by borrowers.

The lack of poor lenders in the commercial banking sector significantly hinders long-term prosperity and poverty eradication. Individual loans are increasingly used by group lending practitioners, underlining the issue of how MFIs handle credit risk. Armendariz and Morduch (2013) identified four essential mechanisms that allow MFIs to obtain high payback rates from low-income borrowers without requiring collateral (Ibtissem & Bouri, 2013). Wang (2022) also highlights the challenges in credit rationing in SME finance and microfinance, including high interest rates, complicated procedures, and high collateral requirements due to asymmetric information.

Asymmetric Information in BMT

The financial intermediary function is essential in Islamic financial institutions to manage the high costs of monitoring, liquidity, and price risk due to the asymmetric information between fund owners and users. Islamic financial institutions aim to provide financing for community economic activities and generate income by setting lending targets in feasible and bankable business sectors. The risk of financing to the community is caused by factors such as highly asymmetric information, community moral hazard, adverse selection problems, and lack of trust in banking, preventing financial institutions from involving the public in financing activities (Kurniawati, 2020).

As stated by Wulandari and Prijadi (2021), one of the critical microfinance issues is that of loans not being given to a certain sector of the population, primarily those at the bottom of the economic pyramid (BOP). The discomfort of high interest rates generates price rationing for those who are unable to obtain microfinance via Islamic or conventional cooperatives. Asymmetric information between lenders and borrowers is crucial in the development of financial intermediation theory (Purwono et al., 2019). If the borrower cannot properly show the business's prospects, the lender will have to invest resources in costly information to determine eligibility. Lenders must devote resources to borrower monitoring, even in cases when a firm's credit risk is acceptable, because of the borrower's tendency to make less-than-ideal investments (Bharath et al. 2011). Islamic financial institutions are confronted with asymmetric information issues that may have a negative influence on their financial health. These issues are caused by various factors that might lead to dangers, and because they are trust-based contracts, they fall into the category of high-risk contracts (Agustianto & Alfafa, 2021).

According to Anisykurlillah et al. (2016), *mudharabah* and *musharakah* are Islamic banking financing systems that face asymmetric information, financing agencies, and moral hazard. Asymmetric information can lead to conflict between agencies and different business performance preferences. Accounting disclosure is necessary to reduce asymmetric information and provide investors with insights into risk management policies. Traditional traders and BMT managers do not make financial transactions in accordance with Sharia law, as they do not prepare financial statements, particularly income statements. However, traditional market traders can make gross profit calculation reports, which can be used as a basic shared distribution between BMT and traditional traders. Based on PSAK 109, Mudharabah Accounting can be calculated using net income and gross profit, suggesting that BMT financing should be given to merchants in accordance with Sharia rules.

In accordance with the Islamic finance issue, Nuansyah (2022) examined financing problems at one of the BMTs, Islamic microfinance in Indonesia, namely Fajar BMT, Metro City. From the results of this study, it was found that the factors that cause non-performing finance in BMT Fajar are unintentional and purposeful factors generated by moral hazard. The mudharib or the client can meet their responsibilities, but they are purposefully tricked by providing misleading information about their business's profitability. The cause is a lack of understanding of the customer's business and financial appraisal of the customer. Compared with Murabaha financing, the level of mudharabah funding in Indonesia is very low. Another study conducted by Sa'diyah and Huda (2018) states that the agency problems that develop in mudharabah finance at BMT Jepara Regency are created by BMT as an agency; specifically, management has not functioned optimally, in addition to moral standards, financing elements, technical aspects, and efficiency concerns.

Regarding how to address asymmetric information issues, Wulandari and Kassim (2016) assert that group lending joint liability reduces credit market failure in developing countries by involving local information and addressing asymmetric information. It improves efficiency and handles unknown borrowers. This program is effective in areas with strong social ties, particularly rural areas, and can alleviate poverty through micro-credit lenders.

Methods

Research Design

This study was conducted on BMTs in Indonesia using a qualitative approach and conventional content analysis methods. Qualitative data are essential for comprehending categories, processes, relationships, and perceptions, particularly in cross-cultural contexts (Drury et al., 2011). It strengthens the narratives of individuals, thereby increasing the credibility of organized efforts (Hesse-Biber, 2010). According to Hsieh and Shannon (2005), content analysis is a flexible technique used to analyze textual data, which can be approached in several ways, from subjective to methodological methods. Researchers select their methodology based on their personal interests and the specific topics they address. Vaismoradi et al. (2013) explain that content analysis is a methodical process of assigning codes and organizing data to examine extensive textual content. It aims to identify the trends, patterns, frequencies, linkages, and communication structures. The objective of this study is to analyze the content of a document by studying the identities of the speakers, the recipients of the message, and its impact. In other words, this analysis is a systematic approach that can be used to find large amounts of textual information by encoding and classifying data to recognize word processes and patterns and their relationships, structures, and discourse communication. In this study, the main question researchers try to answer is: What asymmetric information issues exist in micro-enterprise financing in BMT? The importance of this matter lies in the strong correlation between creditworthiness and trustworthiness, as granting loans indirectly indicates the reliability of a borrower (Becchetti & Conzo, 2011). Private financial intermediaries facilitate the provision of public goods, such as information, which helps mitigate the adverse effects of market failures on economic value. The presence of asymmetric information between small business owners and banks results in elevated interest rates, intricate application procedures, and stringent collateral prerequisites, compelling them to pursue microfinance as an alternative means of acquiring funds (Wang, 2022).

Participants

In the interview inquiry, the sample size was determined by interviews until "data saturation" was achieved. However, no universally accepted approach exists (Robinson, 2014). Data saturation, as defined by Glaser and Strauss (1967), is the stage in data collection where no additional data reveal new dimensions of a conceptual category. The optimal sample size is contingent upon the study's objective and the intricacy, scope, and dispersion of relevant experiences or perspectives, rather than statistical criteria (Robinson, 2014). According to the research technique outlined by Stake in Mthuli et al. (2022), the recommended sample size for a single case study is in the range of 4 to 10. In this study, we examined a single case study that included four samples. From Stake's perspective, the sample size was adequate to achieve data saturation.

The participants in this study were experts from academia and BMT practitioners. The criteria for participants consisted of having experience as founders, administrators, managers, or academics related to BMT as well as the ability and willingness to participate in the research. In this study, voluntary activity refers to any activity that is carried out as a non-profit without receiving material rewards or coercion from certain organizations.

Access to participants and data collection took place from September 1, 2022, to October 12, 2022. The participants were selected using a sampling target according to the criteria of the research participants. After receiving the code of ethics from the Institute of Islamic Banking and Finance, International Islamic University Malaysia, the researcher asked the participants to participate in the study. The researcher first introduced himself and then gave a brief description of the research objectives and needs, and the interview began when the participants signed the written informed consent form. Four participants were selected using targeted sampling. All interviews were recorded with the consent of the participants, and wherever the researcher deemed necessary, field notes were used.

Data Collection

Two methods, face-to-face interviews and video-meeting interviews via zoom, were used to collect the data. Two interviews were conducted face-to-face, one interview was conducted online, and one interview was conducted online, plus written interview answers by participants. The researchers conducted the interviews themselves by guiding the questions (Table 1) developed prior to conducting the interviews. The order of the interview questions for participants varied according to the answers they were given, and other more detailed questions were asked for further research. The average duration of the interviews was 96 minutes, the minimum was 81 minutes, and the maximum was 116 minutes. The time and location of the interviews were determined based on the opinions of the participants. One in-person interview was conducted during the day and at the participant's workplace; another in-person interview was conducted at night at the participant's home; and two online interviews were conducted during the day. This initial interview served as a reference for the next data-mining process in the pilot study.

Table 1. Interview question guide

1. What are asymmetric information issues in micro-enterprise financing of BMT that originate from the implementation of contracts based on sharia principles?
2. What are asymmetric information issues in micro-enterprise financing of BMT that originate from the behavior of BMT staff/managers?
3. What are asymmetric information issues in micro business financing of BMT that originate from the behavior of partners/members of BMT?

Data Analysis

According to Azeem and Salfi (2012), NVivo is a sophisticated software tool used to analyze data. It helps with tasks such as conceptualizing, coding, manipulating, exploring, and understanding data records. It offers expedited access to data records and aids academics in establishing connections between ideas and data by using DataBites, DocLinks, and NodeLinks. NVivo facilitates the management and synthesis of ideas, provides a range of analytical tools to generate novel insights and hypotheses from data, and validates research findings. N-Vivo 12 software was used for data classification. Data analysis was carried out by the author in several steps: In the first step, immediately after each interview, the interview was typed and saved by two members of the research team in the Word 2010 software. Second, the interview text was read and reviewed several times by the researcher to gain understanding. general interview text. In the third step, all the text is read verbatim and carefully, and the code is extracted. In the fourth step, codes with the same content and meaning were placed in the class, and their relations were determined. In the fifth step, the data are placed in the main categories, which are more general and abstract than the previous classification, and themes are extracted. Finally, after analysis, the data are provided in tables, and codes with similar meanings are placed in subcategories. Subcategories that are similar to each other are then placed in categories, and efforts are made so that the subcategories do not overlap. After the final analysis, a thematic analysis was conducted by the principal investigator (AM) to ensure the reliability of the findings, resulting in three emerging themes.

Trustworthiness

The trustworthiness of a qualitative study is based on how believable it is and how true it is based on how the reader perceives it. It has four parts: trustworthiness, confidence, usability, and veracity (Gunawan, 2015). If something is trustworthy, this is is not true. Qualitative researchers should use methods such as meticulous transcription, triangulation, a well-thought-out plan, and coding to ensure that their research is complete. External validity in qualitative research is crucial for ensuring that the findings can be applied to other situations. However, because qualitative projects are specific to a few environments and individuals, it is impossible to apply the findings to other populations. The authors agree on the need for background information, but many do not follow Denscombe's approach (Shenton, 2004). The boundaries of the study should be communicated to the reader, including the number of organizations involved, data collection methods, and time. Furthermore, Shenton (2004) stated that understanding a phenomenon gradually through multiple studies aligns with Dervin's information-seeking principles. Four items of the qualitative research report were observed, and to increase the credibility of the study, the researcher selected participants with the most differences in terms of demographic characteristics to observe the principle of diversity in sampling. At the end of each interview, the researcher briefly stated a general understanding of the participants' experiences, which they confirmed. To increase transferability, all details of the study from sampling to the data collection and analysis processes were explained in full, and citations of participants were provided in person and in bulk.

Ethical Considerations

Ethics are crucial in research, guiding researchers to make informed decisions and considering ethical issues when comparing risks and rewards. The Belmont Report, influenced by the Belmont Commission of the 1970s, lays forth intellectual and ethical underpinnings for safeguarding study participants (Ketefian, 2015). The Department of Health and Human Services (HHS) and every other federal agency in the United States must follow these rules. When conducting medication studies, the FDA also refers to and follows the DHHS recommendations and regulations. The purpose of the current regulations is to keep everyone involved safe. To observe ethics in research, in the first step, entering the research field, approval was obtained from the Institute of Islamic Banking and Finance, International Islamic University of Malaysia through the approval of the supervisor. Written consent was obtained from all participants to participate in the study and record the interviews. At the beginning of each interview, apart from introducing themselves, the researcher explained the purpose and process of the research to the participants and reminded them that they could interrupt the interview anywhere they wanted. In addition, participants were informed of the principles of maintaining confidentiality and keeping the names of participants in publishing the research results. It should be noted that to maintain the health of the participants and researchers themselves, health protocols such as physical distancing and wearing of masks were observed in all interviews.

Results

For a single case study, Stake's research method suggests a group size of 4 to 10, which is sufficient for this case study to have sufficient data (Mthuli et al., 2022). Four people participated in this study; their demographic characteristics are listed in Table 2. After analyzing the data, three categories, five subcategories, and 46 initial codes were obtained (Table 3).

Table 2. Demographic information of participants

Variable	Group	Frequencies
Gender	Male	4
	Female	0
Education	Bachelor's degree	2
	Master's degree	2
Experience	Academics and practitioner	2
	Practitioner	2

Table 3. Codes, subcategories, and categories obtained from analysis of interviews

Category	Subcategory	Codes
Implementation of the contract	Contract	Contracts according to sharia principles, desirable contracts, contracts according to DSN standards, DSN fatwas, buying and selling without wakalah, pressing needs, wakalah not proper.
	Things not allowed in the contract.	Contracts such as conventional banks, insurance, administrative fees, evidence, fines, gharar
	Product Model	Ijarah, istishna', mudharabah, murabahah, musawwamah, musharakah, qardh, qordhul hasan, wadi'ah.
Deviant behavior	Staff/manager behavior	Disbandment, limited energy, fraud, changing market orientation, conflict of interest, unhealthy management, creating opportunities, dark opportunities, limited human resources, poor governance, trust.
	Partner/member behavior	Failure to pay, culture, information manipulation, understanding the essence of the contract, partner character, partner discipline, partner openness, dishonesty, commitment, receptive community, partner does not match the policy

Implementation of the contract

The first category obtained from the data is the implementation of microbusiness financing contracts/contracts. The implementation of this contract includes the activities carried out in making a contract, starting from the selection of financing partners and the continuation of the contract, until the contract is completed.

Contract

According to Ahmed (2014), Islamic finance, a fundamental aspect of Islamic banking, has faced criticism for compromising the Shari'ah principles. Certain products employ numerous valid contracts, resulting in transactions that contravene Islamic laws.

One of the most important aspects of financing is the existence of a contract between BMT and their members/partners. The contract used to finance micro-enterprises at BMT must comply with the Sharia principles. The most desirable sharia-compliant contract in financing is the Murabahah contract, which, according to the standards of the National Sharia Board, is allowed to buy and sell contracts with the wakalah system. However, some BMTs implement murabahah buying and selling contracts by procuring goods directly or indirectly using the Wakalah system. Although the murabahah trading system with the wakalah system is allowed in the DSN MUI fatwa, some BMT experts feel that there is an opportunity for asymmetric information to occur when buying and selling contracts using the wakalah system. Therefore, for conditions that are safer from the risk of untrustworthy behavior of partners and in accordance with the belief in the implementation of contracts that are truly in accordance with Sharia principles, some BMTs choose to use buying and selling contracts with the direct procurement of goods (without wakalah). This can be explained by P1.

> "Yes, murabahah, buying and selling was the most, if it was in the past, then I'll make the contract to be productive, buy whatever supplies, for example my merchandise, e... What is the name of buying rice, for example, we do not, if buying and selling actually the goods must be there it just happened buying and selling right."

> "Because it's a bigger effort."

> "Looks like this, maybe the wakalah still had the risk of an untrustworthy partner not according to the promise, right, and sometimes we can't control it when the money has been handed over to him, right, so after the hijrah, after we try to practice e sharia Actually, it's sharia, we can minimize risks like that because we really buy and sell goods that we deliver real goods, the product is according to what he asked for, and what has been known about it, e.. The next risk is whether the sale credit is selling credit, right? It is in the discipline of the customer to pay installments according to the promise. Well... we are now there, the risk is there, now, but from the NPF figures, thank God, after the hijrah, 2015 can be suppressed, so there is a positive follow-up impact what we can see is by practicing the Sharia principles in the discipline of partners, the commitment of partners to fulfill their obligations…"

Things not allowed in the contract

One of the main things that need to be considered in a contract or financing agreement is what is not allowed in the contract. Several things are prohibited in transactions according to Sharia, namely usury and gharar (obscurity). Some things that are still debated are the insurance used in the financing contract, the existence of transaction costs, the imposition of fines in the case of non-performing financing, and the implementation of contracts as applied to conventional financial institutions. The forbidden things in the contract, if not considered carefully, can become unclear, which also indirectly opens opportunities for asymmetric information to occur in financing. This can be explained by P1.

> "Well, if we pay it off, we will borrow money, if we borrow and borrow money, we can't ask for additional, we can see that it is possible that he shows evidence, but the initial principle doesn't hold in our opinion because the initial principle is buying and selling, so it's better." Do we feel more comfortable, do we think we are more suitable, and feel more secure and comfortable if we do not bring up a lot of e... unclear questions earlier if we do not feel bad."

> "Yes If there is a delay in payment of our installments, there is no fine; if there is no administrative fee for our financing process, it used to exist before 2015 [laughs], that is actually one of the factors, maybe you understand better, there are costs that are not clear like that, Yes, in late payment financial institutions there is a fine, yes, it is recorded as what [laughs], so it becomes unclear.

> "Then we don't have any, we don't have administrative fees either, what kind of administrative costs are they, [laughs] If the documents are already included in the consequences we buy and sell, that's already included in the price component, so there's nothing."

Product models

Many products can be offered to finance micro-entrepreneurs. Several contracts that can be used for micro business financing products are: *ijarah, istishna', mudharabah, murabahah, musawwamah, musharakah, qardh,* and *qordhul hasan*. These contracts have the potential to develop microfinance partner businesses (Khan, 2008; Rahman, 2010). However, a contract carries the risk of asymmetric information. For example, mudharabah and musyarakah contracts require more supervision costs and the risk of manipulating business results reporting data, whereas *murabahah* contracts with *wakalah* provide opportunities for the use of funds that are not in accordance with the original purpose of the contract, and qardh contracts are very risky for bad loans. In dealing with these problems, more effort is needed in terms of product implementation by the manager, and there is a need for awareness from partners to maintain the mandate in carrying out the contract according to Sharia principles. This is explained by the P3.

> "It's been there until now, only because I haven't found the most suitable one, so far, I haven't found what the most suitable formula is..."
>
> "… there are costs that arise that are beyond expectation…"
>
> This was also mentioned by P2:
>
> "If I pay attention to BMT, BMT is sometimes less creative in seeing opportunities, whether it's in funding or financing."

Deviant behavior

The second category that emerges from the data is deviant behavior either on the part of the manager or the part of the financing partner. The existence of asymmetric information from each party can trigger deviations in the form of adverse selection or moral hazard. Islamic ethics can serve as a deterrent against unethical sales methods, establish trust, and influence client loyalty (Wijaya et al., 2022). This, in turn, effectively discourages harmful behaviors and promotes ethical sales practices. While personal piety itself may not be sufficient to avoid aberrant workplace conduct, the use of Islamic piety concepts can effectively reduce such behavior (Siswanto, 2018). Enhancing the caliber of human resources in Islamic banking is essential for tackling issues in the financial sector in Indonesia.

Staff/Manager behavior

Some BMT staff and managers feel that financing using a sale and purchase contract, both with a murabahah contract and a musawwamah contract, is easier to implement and has a lower risk than financing using a musharaka contract, let alone *mudharabah*. However, the use of buying and selling contracts with *wakalah* allows partners to use funds that are not in accordance with their original purpose. Thus, information is hidden during the implementation of the contract.

The implementation of the sales and purchase contract without using the wakalah system, namely, the procurement of goods to be transacted directly, requires a great effort for the BMT manager. In addition, BMT managers need to understand how the contract mechanism is in accordance with the Sharia principles. This ensures the actual implementation of the contract in accordance with the Sharia principles.

Another important aspect from the management side is the need for a high commitment from the manager to apply Sharia principles in every activity related to partner micro-business financing. It is important to note, based on the explanation of one of the participants managing the BMT regarding cases of hiding information from the manager's side, especially those in charge of financing installment payments. Honesty and openness of managers in submitting partner financing reports are necessary for the successful completion of contract transactions. This can be explained by P1.

> "The risk is higher, when the goods have been purchased by us, then the person concerned is called to cancel it, the risk is with us because there is no transaction or contract, because in our principle we must have the goods, right ..."

> "Yes, that's right, ma'am, there are many opportunities, so we do not control it, then if you bought it, you said you wanted to buy 10 kg, did you really buy 10 kg, said the price was 10k, was it really 10k, maybe later after receiving the money, we sometimes get it 's a risk to change the story, right?"

> "Where does the money go, the customer is BMT, he doesn't need to know what I bought, the important thing is that I pay it off?"

Islamic financial institutions depend on Shariah auditors to identify dishonest activities and enforce ethical standards, thereby avoiding legal repercussions and guaranteeing that public accountants are well-versed in fraud auditing (Suryanto & Ridwansyah, 2016).

Partner/member behavior

Based on the results of the interviews, several problems related to financing partners were identified, namely non-performing financing and defaults. The financing partner does not understand the essence or mechanism of the contract being implemented, resulting in a misunderstanding of the completion of the contract. The diverse characteristics of partners are also a problem. Partners who have a bad character are likely to act dishonestly in financing, such as manipulation of procurement information and/or manipulation of business reports. It requires high commitment and discipline of partners in the implementation of financing contracts. This becomes difficult in the case of BMT dealing with partners who are not suitable or are less able to accept the implementation of the contract in accordance with Sharia principles. Some partners were found to prefer other financial institutions in terms of financing because they could not accept the new BMT policy that strictly implemented the contract in accordance with Sharia principles. This has become a new problem for BMT, especially during the early transition period, when partners/members have experienced a decline. However, based on the experience of the three BMT practitioners, it is stated that over time, BMT will get new partners/members who can accept the implementation of contracts according to Sharia principles. This indicates the need to increase awareness and literacy about Islamic finance in the community. This can be explained by P1.

> "The principle of sharia is the discipline of partners, the commitment of partners to fulfill their obligations..."

> "…So, if there are problems with non-currents, when we monitor it, where is the problem identified, so that in the end it can reduce the risk of default, right, so sometimes we e... See that yes, there are problems. faced by the partner'."

Regarding member behavior, P2 also explained:

> "Various obstacles from external parties that are often faced by BMT La-Tansa, among others, are partners who lack detail in reading the points written in the contract agreement even though they have actually been conveyed at the time the contract was signed. This prevents them from understanding the essence of the agreed contract. There are also times when the price of goods changes when they are initially submitted and spent."

Discussion

The purpose of this study is to identify the issues and challenges related to asymmetric information on micro-enterprise financing in BMT using a qualitative approach. The results of this study indicate that asymmetric information can occur in two aspects: the implementation of the contract and deviant behavior both from the BMT manager and/or from the partners/members of the

BMT who apply for financing. In the implementation of a contract, asymmetric information can occur when there is an opportunity to implement the contract. For example, concealing information related to the allocation of funds in buying and selling transactions, either by means of musawwamah or murabahah contracts. In this case, asymmetric information can occur from the manager, who hides information related to the data on the procurement of goods to be traded, from the financing partner, namely by misuse of the allocation of financing funds with the wakalah system, or it can occur with cooperation between management staff and financing partners in manipulation information related to financing.

In this case, it can be said that financing contracts according to Sharia principles are not perfectly implemented. A previous study conducted by Wulandari et al. (2021) stated that Islamic MFIs, one of which is BMTs, sometimes do not have a history of financing their borrowers, and Islamic condition it can be said that Islamic MFIs face risks associated with asymmetric information between borrowers and lenders. In dealing with these problems, BMTs can offer innovative lending mechanisms, such as group lending, joint liability, monitoring, and individual collateralized loans ("guaranteed" payments with promise: access to larger loans in the future depends on current financing payments) (Wulandari & Prijadi, 2021). In another study, Alam et al. (2022) compared the risks of murabahah and mudharabah financing in BMT. The findings from the study indicate that the risk of mudharabah financing is greater than that of murabaha financing. In practice, mudharabah financing tends to be relatively high because of asymmetric information and moral hazards. The risk inherent in *murabahah* financing is the risk of member default due to default or member negligence in repaying installments. This study also identifies risk factors, such as trust risk and sharia legal risk for murabahah financing with wakalah contracts.

Another issue related to asymmetric information is deviant behavior by managers, partners/members, and cooperation between managers and partners/members. Management allows BMT members to hide information related to reporting results of monitoring partner conditions in the field. For example, the manipulation of reporting on the number of installments paid by partners and reporting on partners' business conditions is not in accordance with the real conditions in the field. On the other hand, partners can also manipulate reports of business carried out, which can affect the amount of lower profit sharing in *mudharabah* or *musharaka* contracts. In certain cases, cooperation can also occur in terms of data manipulation of business reports from management staff and financing partners.

Satar and Kassim (2020) investigated the experiences of two prominent Indonesian and Malaysian IMFIs, Baitul Maal Wat Tamwil (BMT) and Amanah Ikhtiar Malaysia (AIM). Based on this research, it was found that small loans are expensive because of high administrative costs, which often include a significant fixed cost. AIM must find a way to cut transaction costs as these charges are frequently passed on to clients. Like other microfinance organizations, has significant transaction costs due to information issues. Regarding the agency problem at BMT, Aminudin (2020) states that there are two issues with funding the Musyarakah contract: adverse selection and moral hazard. BMT "Dana Mentari" Muhammadiyah Purwokerto for example (Aminudin, 2020), determines the ideal profit sharing scheme through a variety of procedures, including developing a profit-sharing plan, hosting entrepreneurship and cooperative workshops, and establishing discussion policies. Sa'diyah and Huda (2018) examined agency problems at another BMT, namely BMT in Jepara Regency, finding that the funding of Mudharobah in the Jepara Regency BMT originates from BMT as an agency, which means that management has not been completely exploited, in addition to being caused by moral standards, finance elements, technical aspects, and efficiency concerns. Project screening, mudhorib screening, and compliance with shahibul maal and mundharib on Sharia standards in mudaraba contracts are effective problem-solving solutions to agency difficulties.

Conclusion

The results of the study showed that asymmetric information can occur in two ways: contract implementation and deviant behavior on the part of the BMT management and/or partners/members who ask for finance. In addition, this study analyzes risk elements such as trust risk and moral hazard. Previous studies have revealed that Islamic MFIs do not always have a record of funding their clients. BMTs can address these issues by providing new lending mechanisms such as group lending, joint responsibility, monitoring, and individual collateralized loans. Management allows BMT members to hide information related to reporting results of monitoring partner conditions in the field. Partners can also modify business data, affecting the amount of less profit-sharing in *mudharabah* or *musharaka* contracts. Small loans are costly because of high administrative overheads, which sometimes involve substantial fixed costs. The BMT must find a method to reduce transaction expenses, which are typically passed on to customers.

This study is one of the few that qualitatively examines the issue of asymmetric information on micro business financing in BMT from the perspective of experts who have experience in research related to BMT and, as founders, administrators, or managers of BMTs that allow participants to explain phenomena in real terms. based on their expertise and experience. One of the main limitations is identifying and accessing the participants, as there are no official statistics or addresses of these people and the hectic activity of the participants, so the researcher needs to communicate with the participants several times to obtain the consent of the participants and then find the right time to conduct an interview. Additional methodologies involving interviews, observations, and documentation can be employed to enhance the depth of research. It is recommended that a larger number of participants from various BMTs provide valuable insights, thereby facilitating the acquisition of more extensive and comprehensive information.

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