


## Chapter 2

# Understanding the Behavior of Qardhul Hassan Borrowers in Nano-Entrepreneurship: A Field Experiment of Islamic Nanofinance

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## ABSTRACT

*Most emerging countries have communities categorized as excluded and underserved, unbanked and underbanked, the bottom of the pyramid (BoP), and ultra poor which have no ability to access bank financing. They are often victims of loan sharks. They should be a target of microfinance, but most banks and also microfinance institutions (MFIs) do not yet do well in serving them. Likewise, Islamic microfinance in fact has also not succeeded in reaching these people. Islamic nanofinance through qardhul hassan is promoted as a new paradigm to fill the Islamic microfinance gap. Through a field experiment for eight months by providing a fund IDR5 million with a maximum loan IDR1 million to provide nanofinancing, this study investigated the financial behavior of the nano-entrepreneurs in managing the qardhul hassan in Indonesia. The outcome of this study is expected to be input for policymakers, especially for the Islamic micro-industry, to come up with financing schemes according to the characteristics of these communities.*

## INTRODUCTION

Most emerging countries have very poor people in large numbers. They have no ability to access bank financing, particularly in rural areas. Asian Development Bank [ADB] (2000), Robinson (2001), Morduch

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& Haley (2002), Segrado (2005), and Leikem (2012) mentioned that microfinance is a powerful and effective tool for poverty alleviation. However, Duvall (2004), Bateman (2011), Parpart (2014), Mahanti (2018), Musari & Simanjuntak (2016), Musari (2016b, 2019, 2020b, 2020c) found the microfinance institutions (MFIs) in some countries charge high rates to poor people, although they are bit lower than local loan sharks interest rates. Nevertheless, the rates of small loans to poor people are generally more expensive than the rate of normal commercial banks.

In order to provide more opportunities for financial services for the impoverished, meager income, and very low enterprises, then come to the term ‘nanofinance’. Not many literature reviews about nanofinance. The presence of nanofinance has not been accepted as much awareness as microfinance in theoretical work. However, Pathak & Sriram (2004), Mahanti (2008), Ray (2008), Parpart (2014), Chonlaworn & Pongpirodom (2015), Musari & Simanjuntak (2016), Musari (2016b, 2020b, 2020c) highlighted that nanofinance practices can be found in some Asian countries like Thailand, India, Cambodia, and also Indonesia.

Referring to Mahanti (2008) and Musari (2016b, 2017c, 2020b, 2020c), it can be drawn a common thread related to nanofinance. Its missions are to permit the people in the bottom of the pyramid (BoP) to have easier access to obtain financing, to encourage people in BoP to have (small) business; and to avoid them to go to the loanshark. Generally, the user of nanofinance is women with ultra micro businesses ---or can also be called as nano enterprises, and afterward in this paper will be called so--- which have no access to capital from banks and also MFIs because have no guarantee or collateral.

*In Indonesia, nano economy is a representation of the face of the people’s economy (Musari, 2020a) and nanofinance also can address the gap of Islamic microfinance (Musari, 2017b). To encourage the existence of Islamic nanofinance as a new paradigm to fill the Islamic microfinance gap, qardhul hassan as a better contract (Musari, 2017c, 2019, 2020c, 2020d).*

## **METHOD**

By using a qualitative approach, this applied research using a field experiment in Situbondo, East Java Province, with the nanofinance project name “Rumah Qardhul Hassan (RQH)” or House of Qardhul Hassan. RQH allocated IDR5 million as capital with a maximum loan of IDR1 million to understand the behavior of *qardhul hassan* borrowers in managing the funds for eight months.

The target of this field experiment was people who are categorized as excluded and underserved, unbanked and underbanked, BoP, and very poor/ultra poor as well as ultra micro/super micro enterprises. Then, Situbondo was chosen as the experimental location because the widest micro small medium enterprises (MSMEs) network that the research team could access was in this regency. By considering the need to make sure the borrowers to open-heart in providing information, this experiment must find the close relationship between borrowers and the RQH operator which is an extension of the research team.

Furthermore, a field experiment was taken in this study to find the characteristic of borrowers as representatives of nano enterprises and ultra-micro communities, their reason to access nanofinance, what is the mindset of them regarding ‘debt’, their ability to pay this soft loan, etc. In order to establish the validity of a number of findings in the field, this study also confirmed them by interviewing a practitioner of an Islamic bank.

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