Islamic Microfinance, Household Welfare, and Multidimensional Poverty: Evidence from Central Java, Indonesia

Sri Wiranti Setiyanti[1], Jefri Heridiansyah[2], Catur Prabowo*

[1,2] *Indonesian Digital Science and Technology University (USTEDI/STIEMA), Indonesia*
[3] *STMIK Himsya, Indonesia*

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Corresponding Author:
setiyantisriwiranti@gmail.com

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A B S T R A C T

Poverty remains a multidimensional development challenge in Indonesia, particularly in the informal sector, such as micro-enterprises. This study analyzes the role of Islamic microfinance through Baitul Maal wa Tamwīl (BMT) in reducing poverty and improving the welfare of recipient households. The study employed a mixed-methods approach with an explanatory sequential design. The study used panel data regression on 100 BMT recipient households in Central Java Province during 2020–2024, while qualitative analysis used in-depth interviews to explain social and institutional mechanisms. The results show that BMT financing has a negative and significant effect on income poverty and multidimensional poverty, and a positive effect on income and consumption stability, financial resilience, and the sustainability of micro-enterprises. The profit-sharing contract scheme and access to Islamic social funds have been shown to strengthen the impact of financing o. These findings confirm that BMT's socio-commercial character is a key mechanism for effective financing and achieving sustainable development goals.

A B S T R A K

Kemiskinan masih menjadi tantangan pembangunan yang bersifat multidimensional di Indonesia, khususnya di sektor informal, seperti di kalangan melalui Baitul Maal wa Tamwīl (BMT) dalam mengurangi kemiskinan dan meningkatkan kesejahteraan rumah tangga penerima pembiayaan. Penelitian menggunakan pendekatan mixed-methods dengan desain explanatory sequential. Analisis ini kuantitatif dilakukan menggunakan regresi datadilakukan secara kuantitatif menggunakan regresi data panel terhadap 100 penerima pemdilakukan secara kuantitatif dara analisis kualitatif dilakukan melalui wawancara mendalam untuk menjelaskan mekanisme sosial dan kelembagaan. Hasil penelitian menunjukkan bahwa pembiayaan BMT berpengaruh negatif dan signifikan terhadap kemiskinan pendapatan dan kemiskinan multidimensional, serta berpengaruh positif terhadap stabilitas pendapatan dan konsumsi, ketahanan finansial, dan keberlanjutan usaha mikro. Skema akad berbasis bagi hasil dan akses terhadap dana sosial Islam terbukti memperkuat dampak pembiayaan terhadap kesejahteraan rumah tangga. Hal ini menegaskan bahwa karakter social komersial BMT merupakan mekanisme kunci efektivitas mikro finansial syariah dalam pengentasan kemiskinan an pencapaian tujuan pembangunan berkelanjutan

1. INTRODUCTION

Poverty remains one of the most persistent and complex socioeconomic challenges facing many Muslim-majority countries, including Indonesia. Despite relatively steady economic growth and the implementation of various poverty alleviation programs over the past decade, poverty continues to manifest in multiple dimensions. It is characterized not only by low income levels but also by limited access to education, healthcare, financial services, and economic opportunities (Aguilar & Sumner, 2020). In Indonesia, micro-entrepreneurs and informal-sector workers are among the most vulnerable groups, as they often face structural barriers to accessing formal financial institutions, including insufficient collateral, unstable income streams, and limited financial literacy (Kadir et al., 2025).

Access to inclusive, ethically grounded financial services is widely recognized as a crucial means of alleviating poverty and achieving sustainable development objectives. Conventional microfinance has long been promoted to address financial exclusion (Yunus & Mahadi, 2025). However, its reliance on interest-based financing and debt-oriented mechanisms has drawn substantial criticism concerning sustainability, social justice, and borrower vulnerability, particularly in Muslim-majority countries (Alorifi et al., 2019). These limitations have prompted growing interest in Islamic microfinance as an alternative aligned with Sharia principles, emphasizing profit-and-loss sharing, ethical investment, social responsibility, and equitable wealth distribution.

Islamic Microfinance Institutions (IMFIs) operate according to principles that prohibit usury (riba) and promote profit-sharing arrangements, asset-based financing, and social solidarity mechanisms, including zakat, sadaqah, and waqf. In Indonesia, Baitul Maal wa Tamwīl (BMT) has emerged as a distinctive and widely adopted model of Islamic microfinance. BMT integrates maal functions (social finance activities), including the management of zakat and other social funds, with tamwīl functions (commercial financing) designed to support micro-entrepreneurs and low-income households (Bayani et al., 2025); (Azzahro et al., 2025). This dual institutional structure positions BMT as a potentially effective instrument for alleviating poverty and enhancing household welfare (Fendari et al., 2023).

A growing body of literature has examined the role of Islamic microfinance in reducing poverty and promoting financial inclusion. Empirical studies generally indicate that participation in Islamic microfinance programs contributes to income growth, improved business performance, and greater economic stability among beneficiaries. These findings affirm the positive role of Islamic microfinance in reducing economic vulnerability among financially excluded populations in Muslim-majority countries (Hidayat et al., 2023); (Hassan et al., 2022). Kamal & Khattak, (2022) argue that Sharia-compliant microfinance mechanisms are particularly effective in reducing poverty because they align financial objectives with social and ethical values. Similarly, Danlami et al., (2024) find that participation in Islamic microfinance positively affects household income and consumption patterns across several Muslim-majority countries.

Nevertheless, many existing studies continue to define poverty alleviation narrowly through single-dimensional economic indicators, such as income growth or business profitability (Rohman et al., 2021). These approaches do not fully capture the multidimensional nature of poverty emphasized in development economics and the Islamic moral economy, both of which conceptualize welfare as encompassing material, social, and spiritual dimensions (Wanto et al., 2021). Consequently, broader aspects of household welfare, including consumption stability, access to education and healthcare, and financial resilience, remain underexplored in research on the impacts of Islamic microfinance. Although Islamic microfinance is theoretically grounded in Sharia principles, including risk-sharing, social justice, and equitable distribution, many empirical studies do not explicitly operationalize these principles within their analytical frameworks. Islamic microfinance is often treated as a functional substitute for conventional microfinance, with primary emphasis placed on the provision of financing rather than on the normative and institutional characteristics that distinguish it (Muzaki et al., 2025). This gap constrains theoretical advancement in Islamic finance research, particularly in journals that prioritize robust conceptual foundations and theory-driven empirical analysis. Furthermore, the geographical distribution of existing studies remains uneven, with a predominant focus on South Asian and Middle Eastern countries, such as Pakistan, Bangladesh, and Sudan (Noor & Ayaz, 2023). Many studies also adopt an aggregate institutional perspective, treating Islamic microfinance institutions as homogeneous entities. Such approaches obscure institution-specific dynamics, particularly the socio-commercial hybrid nature of BMT, which combines Islamic social finance instruments with commercial

Microfinancing activities. Prior studies have also identified methodological limitations, including small sample sizes, limited robustness testing, and inadequate controls for household-level socioeconomic

heterogeneity, which weaken causal inference (Z. Khan et al., 2021; Khandelwal & Aljifri, 2021). To address these gaps, this study adopts a mixed-methods approach that integrates panel data from Indonesian provinces with in-depth interviews with Islamic microfinance beneficiaries. This design enables a comprehensive assessment of Islamic microfinance's impact on poverty reduction and household welfare within the Sustainable Development Goals (SDGs) framework.

The primary objective of this study is to examine the role of Islamic microfinance in reducing poverty and enhancing household welfare by providing household-level empirical evidence from BMT beneficiaries. Specifically, the study aims to: (1) analyze the impact of BMT financing on poverty reduction; (2) assess its effects across multiple dimensions of household welfare; and (3) identify the roles and strategies of policymakers and stakeholders in strengthening the effectiveness of Islamic microfinance as a poverty alleviation policy instrument aligned with the Sustainable Development Goals, particularly SDG 1 (No Poverty), SDG 8 (Decent Work and Economic Growth), and SDG 10 (Reduced Inequalities).

2. THEORETICAL FRAMEWORK AND HYPOTHESES

2.1 Poverty Theory and the Multidimensional Approach

Poverty is a complex socioeconomic phenomenon that cannot be adequately understood through a single indicator, such as income. In contemporary development economics, poverty is increasingly conceptualized as a condition of multidimensional deprivation encompassing limitations in the fulfillment of basic needs, access to education and healthcare services, decent employment, and social and economic participation (H. A. Khan, 2004); (Intyas et al., 2022); (Purwaningsih et al., 2025). This perspective emphasizes that human well-being is determined not solely by income-generating capacity but also by the capabilities of individuals and households to lead lives they have reason to value. The Multidimensional Poverty Index (MPI), developed by Alkire & Foster, (2011), further strengthens this understanding by explicitly incorporating the dimensions of health, education, and living standards into poverty measurement. This multidimensional approach is particularly relevant in developing-country contexts, including Indonesia, where poor households often experience multiple and simultaneous structural vulnerabilities. Consequently, poverty analyses that focus exclusively on income-based measures risk overlooking other equally important dimensions of human well-being (Colombo, 2010). From the perspective of Islamic economics, poverty is also viewed as a condition of social imbalance that hinders the realization of the objectives of maqāṣid al-sharīʻah, particularly the protection of life (ḥifẓ al-nafs), intellect (ḥifẓ al-ʻaql), wealth (ḥifẓ al-māl), and progeny (ḥifẓ al-nasl). Rusydiana & As-Salafiyah, (2021) emphasize that welfare in Islamic economics is inherently holistic, encompassing material, social, and spiritual dimensions. Similarly, (Chapra, 2016). argues that economic development in Islam is ultimately directed toward achieving social justice, human dignity, and balanced socioeconomic relations. Accordingly, poverty alleviation within the Islamic framework is not limited to increasing income levels but also aims to promote social justice and economic equilibrium.

2.2 Financial Inclusion Theory

Financial inclusion is defined as a condition in which all segments of society have adequate access to affordable, high-quality, and sustainable formal financial services (Grady et al., 2018). It is widely recognized as a critical mechanism for poverty reduction, enabling poor households to manage economic risks, enhance business productivity, and access broader economic opportunities. Through access to savings, credit, insurance, and payment services, financially included households are better equipped to smooth consumption and invest in income-generating activities. However, existing literature also indicates that conventional financial systems often fail to reach low-income populations and micro-entrepreneurs effectively because of stringent collateral requirements, high transaction costs, and limited financial literacy (Demirguc-Kunt et al., 2018). Consequently, a substantial proportion of poor individuals remain excluded from formal financial institutions, reinforcing cycles of vulnerability and economic marginalization. In predominantly Muslim societies, barriers to financial inclusion are further intensified by religious considerations, particularly the rejection of interest-based financial systems. In this context, Islamic microfinance is increasingly viewed as a more appropriate instrument for promoting financial inclusion, as it offers services aligned with religious values, ethical principles, and social justice objectives (Mutamimah et al.,2021). By integrating Sharīʿah principles, including risk-sharing, the prohibition of interest (ribā), and social responsibility, Islamic microfinance institutions have the potential to serve unbanked populations that were previously unwilling or unable to access formal financial

services. Consequently, Islamic microfinance plays a strategic role in expanding inclusive financial access while promoting equitable and sustainable economic development.

2.3 Islamic Microfinance Theory

Islamic microfinance represents an adaptation of the microfinance concept to the principles of Islamic Sharia. Unlike conventional microfinance, which is based on interest and debt, Islamic microfinance emphasizes the prohibition of usury, profit-sharing, asset-based financing, justice, and social responsibility (A. A. Khan, 2009). It is grounded in the concept of risk-sharing rather than risk transfer, ensuring that business risks are not borne entirely by the recipient of the financing. Schemes such as mudharabah, musyarakah, and murabahah are designed to establish partnerships between financial institutions and customers, rather than merely creating creditor-debtor relationships (Ahmed, 2002). Meanwhile, Hassan et al. (2021) emphasize that Islamic microfinance offers normative advantages because it integrates economic objectives with social values, including empowerment, justice, and collective welfare. Accordingly, Islamic microfinance serves not only as a financial instrument but also as a mechanism for social development.

2.4 Baitul Maal wa Tamwīl (BMT)

Baitul Maal wa Tamwīl (BMT) is a distinctive form of Islamic microfinance institution in Indonesia. BMTs are characterized by the integration of maal (social finance) and tamwīl (commercial finance). The maal function encompasses the management of zakat, infaq, and sedekah, while the tamwīl function focuses on financing micro- and small-scale businesses (Ashraf, 2023). This model gives BMTs a comparative advantage in poverty alleviation, as they can support low-income households through a combination of social assistance and productive financing. Soemitra et al. (2022) demonstrated that integrating social and commercial finance within BMTs significantly contributes to improving household welfare and strengthening the economic resilience of micro-entrepreneurs. However, Kunhibava et al. (2024) noted that many studies continue to analyze Islamic microfinance institutions in aggregate, thereby overlooking the specific dynamics of BMTs as community-based institutions operating within distinct social contexts. Accordingly, household-level and locally contextualized analyses are essential to understanding more accurately the impact of BMTs on community welfare.

2.5 Islamic Microfinance, Welfare, and the SDGs

Within the framework of the Sustainable Development Goals (SDGs), Islamic microfinance is directly relevant to poverty alleviation (SDG 1), the creation of decent work and promotion of economic growth (SDG 8), and the reduction of inequality (SDG 10). Fianto et al. (2018) find that Islamic microfinance contributes to reducing multidimensional poverty by improving income stability, household consumption, and access to basic services. I. Khan et al. (2024) and Malik (2024) emphasize that, although many studies report positive impacts, methodological limitations—including small sample sizes and weak causal inference—remain significant challenges. Accordingly, a mixed-methods approach and the use of household-level microdata are considered better suited to capturing the true impact of Islamic microfinance on household welfare.

3. RESEARCH METHOD

This study adopted a mixed-methods approach using an explanatory sequential design (Creswell, 2021). It integrated quantitative and qualitative analyses to provide a comprehensive understanding of the effects of Islamic microfinance on poverty reduction and household welfare. The quantitative phase was conducted first to examine the empirical relationships between BMT financing and poverty and welfare indicators. This was followed by a qualitative phase involving in-depth interviews, which enriched the interpretation of the findings and clarified the underlying social and institutional mechanisms (Alkire et al., 2021).

The study population comprised households that received productive financing from Baitul Maal wa Tamwīl (BMT) in Indonesia between 2020 and 2024. The quantitative sample included households receiving BMT financing across 20 provinces, selected proportionally to account for regional variations in poverty levels and financial inclusion. The qualitative component comprised 40–50 informants, including BMT beneficiaries, BMT managers, and other stakeholders.

Table 1. Operationalization of Research Variables

1. Independent Variables / Islamic Microfinance Financing by BMT (X)

Variable	Operational Definition	Indicators	Measurement Scale	Data Source
BMT Financing	Total amount of productive Islamic financing received by households from BMT	Financing amount (IDR)	Ratio	BMT records / Household survey
Type of Contract	Type of Sharia-compliant financing contract applied	Murabahah, Mudharabah, Musharakah	Nominal (dummy)	BMT records
Length of Participation	Duration of household participation as a BMT member/financing beneficiary	Number of years of participation	Ratio	BMT records
Access to Social Funds	Household access to Islamic social funds through BMT	Zakat, Infaq, Ṣadaqah (yes/no)	Dummy	Household survey

2. Dependent Variables / Poverty (Y1)

Variable	Operational Definition	Indicators	Measurement Scale	Data Source
Income Poverty	Household poverty status based on the national poverty line	Per capita income relative to the poverty line	Dummy / Ratio	Statistics Indonesia (BPS) / Household survey
Multidimensional Poverty (MPI)	Degree of household deprivation across multiple welfare dimensions	Education, Health, Standard of Living	Index (0–1)	Household survey

3. Dependent Variables / Household Welfare (Y2)

Variable	Operational Definition	Indicators	Measurement Scale	Data Source
Income Stability	Consistency of household income over time	Variability of monthly income	Ratio	Household survey
Consumption Stability	Household ability to maintain basic consumption levels	Household consumption expenditure	Ratio	Household survey
Access to Basic Services	Household access to education and health services	Children's education, healthcare access	Ordinal / Dummy	Household survey
Financial Resilience	Household capacity to cope with economic shocks	Savings, coping mechanisms	Index	Household survey
Business Sustainability	Ability of micro-enterprises to survive and grow	Business continuity, business growth	Dummy / Ordinal	Household survey & BMT records

4. Control Variables / Household Socio-Economic Characteristics (Z)

Variable	Operational Definition	Measurement Scale	Data Source
Age of Household Head	Age of the household head (years)	Ratio	Household survey
Education of Household Head	Highest level of formal education attained	Ordinal	Household survey
Household Size	Total number of household members	Ratio	Household survey
Location	Household residential area	Dummy (Rural/Urban)	Household survey
Type of Business	Category of micro-enterprise operated	Nominal	Household survey

1. Control Variables / Household Socio-Economic Characteristics (Z)

The study employed a multistage sampling technique. Provinces were purposively selected based on the presence of active BMTs and the availability of data. Households were selected through stratified random sampling, with strata defined by business type, length of membership, and financing scheme. Qualitative informants were selected using purposive and snowball sampling (Sekaran & Bougie, 2017).

The primary independent variable was BMT Sharia microfinance financing, measured by the financing amount, contract type, duration of participation, and access to social funds. The dependent variables comprised poverty, assessed using the income poverty line and the multidimensional poverty index, and household welfare, assessed based on income and consumption stability, access to basic services, financial resilience, and business sustainability. Control variables included household socioeconomic characteristics (Namayengo et al., 2025).

The analysis employs panel-data regression models (fixed-effects and random-effects) to estimate the effects of BMT financing on poverty and household welfare. Robustness tests are conducted to strengthen the validity of causal inferences. Qualitative data are analyzed thematically to identify the social mechanisms, sharia values, and institutional role of BMTs in shaping household welfare (Braun & Clarke, 2023).

4. DATA ANALYSIS AND DISCUSSION

Central Java Province provides a relevant context for examining the close relationship between poverty among micro-enterprise households and the role of community-based Islamic microfinance institutions. Although poverty rates in Central Java have declined over the past decade, micro-enterprise households, particularly those in the informal sector, continue to face income vulnerability, limited access to financing, and low financial resilience. These conditions make the province a suitable empirical setting for assessing the effects of Baitul Maal wa Tamwil (BMT) financing on poverty and household welfare. The region's economic structure, which is dominated by micro and small businesses, further underscores the strategic role of BMTs as institutions that combine productive financing based on Islamic contracts with Islamic social funds. This study analyzed 100 households that received BMT financing between 2020 and 2024 in Demak, Kudus, and Pati Regencies, Salatiga and Ungaran, and Semarang City.

Descriptive Analysis

The regression results in Table 3 indicate that Islamic microfinance financing provided by BMTs has a negative, statistically significant effect on household poverty levels. A 1% increase in BMT financing reduces the probability of a household falling below the poverty line by approximately 0.18 percentage points and significantly decreases the multidimensional poverty index. Access to Islamic social funds (zakat, infaq, and sedekah) also exerts a strong, independent poverty-reduction effect. These findings confirm that integrating social finance with productive financing is a key mechanism underlying BMTs' effectiveness in alleviating poverty.

Impact of BMT Financing on Household Welfare

As shown in Table 2, BMT-financed households show substantial variation in financing received, participation duration, and welfare outcomes. Approximately 42 percent of households have access to Islamic social funds through BMT, underscoring the institution's strong socio-commercial (hybrid) character.

Impact of BMT Financing on Poverty Reduction

BMT financing has a positive and statistically significant impact across all dimensions of household welfare. Its greatest effect is observed in the financial resilience and sustainability of micro-enterprises, indicating that Islamic microfinance not only increases short-term income but also strengthens households' long-term economic stability. Profit-sharing schemes consistently yield better outcomes than sale-based contracts, supporting the theoretical argument in Islamic economics for the superiority of risk-sharing mechanisms.

Table 2. Descriptive Statistics of Research Variables

Variable	Observation	Mean	Std. Dev.	Min.	Max.
BMT Financing (ln)	4.800	14,21	0,87	12,10	16,45
Duration of Participation (years)	4.800	3,6	1,9	1	9
Access to Social Funds (dummy)	4.800	0,42	0,49	0	1
Household Income (ln)	4.800	13,98	0,81	12,05	16,10
Multidimensional Poverty Index (MPI)	4.800	0,246	0,118	0,05	0,62
Financial Resilience Index	4.800	0,53	0,21	0,10	0,95

Table 3. Panel Data Regression Results: Impact on Poverty

Variable Independen	Income Poverty (Y1)	MPI (Y2)
BMT Financing (ln)	**–0,182*** (0,041)	**–0,037*** (0,009)
Duration of Participation	–0,024** (0,011)	–0,006** (0,003)
Profit-Sharing Contract	–0,091** (0,039)	–0,018** (0,007)
Access to Social Funds	**–0,143*** (0,035)	**–0,029*** (0,008)
Household Head's Education	–0,056*** (0,014)	–0,012*** (0,004)
Household Size	0,031** (0,015)	0,007* (0,004)
Urban Location	–0,068* (0,037)	–0,014* (0,008)
Household Fixed Effects	Yes	Yes
Time Fixed Effects	Yes	Yes
Observations	4.800	4.800
R^2 (within)	–	0,41

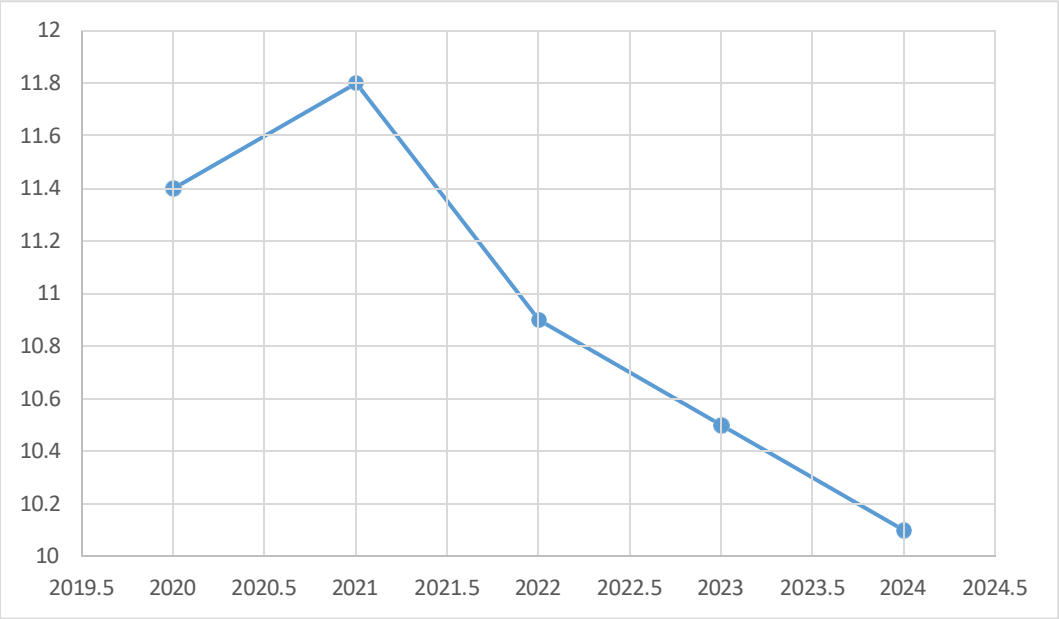
Source: Processed research data, 2025

Table 4. Panel Data Regression Results: Welfare Indicators

Variables	Income Stability	Consumption Stability	Financial Resilience	Business Sustainability
BMT Financing (ln)	0.164*	0.138*	0.211*	0.189*
Duration of Participation	0.021**	0.018*	0.027**	0.024**
Profit-Sharing Contract	0.049*	0.061**	0.073**	0.088***
Access to Social Funds	0.092*	0.107*	0.126*	0.084
Household Head's Education	0.031***	0.028***	0.034***	0.019**
Control Variables	Yes	Yes	Yes	Yes
Fixed Effects	Household & Time	Household & Time	Household & Time	Household & Time

Source: Processed research data, 2025

Poverty in Central Java (Graphic Description)



(Line graph: X axis = years, Y axis = percentage of poor population)

Figure 1. Poverty Level in Central Java, 2020–2024

Figure 1 illustrates that poverty fluctuated significantly between 2020 and 2024 before declining consistently. The poverty rate was 11.4% in 2020 and rose to 11.8% in 2021. This increase was likely influenced by external factors, including the effects of the COVID-19 pandemic and economic disruptions that constrained the incomes of low-income households. From 2022 onward, however, the rate declined steadily, reaching 10.9% in 2022, 10.5% in 2023, and 10.1% in 2024. This downward trend suggests that BMT interventions, which combine Sharia-based microfinance with social funding support, may positively affect household economic well-being.

The research findings indicate that BMT-based Islamic microfinance significantly reduces poverty and enhances household welfare across multiple dimensions. These findings contribute to the Islamic economics literature and provide empirical evidence of the BMT model's relevance as a policy instrument for achieving the Sustainable Development Goals.

5. DISCUSSION

Sharia Microfinance and Poverty Reduction

The findings provide robust evidence that Islamic microfinance delivered through Baitul Maal wa Tamwīl (BMT) plays a significant role in reducing both income-based and multidimensional household poverty. These results align with the theoretical framework of Islamic development economics, which positions inclusive financial access as a key instrument for expanding the economic capabilities of poor and vulnerable groups. The negative and statistically significant coefficients for BMT financing indicate that increased access to Sharia-compliant productive capital enhances

Household productive capacity, income generation, and resilience to economic shocks are strengthened. Unlike conventional microfinance, Islamic microfinance emphasizes justice, affordability, and sustainability, making it more responsive to the structural constraints faced by low-income households.

Sabiti and Effendi (2017) argue that Islamic microfinance financing effectively improves household income and expenditure patterns and contributes to poverty reduction at the local community level. These findings reinforce the role of Sharia-compliant financing in enhancing microenterprise performance and the economic welfare of beneficiary households. Furthermore, Islamic microfinance has been identified as one of the most effective instruments for poverty alleviation in Muslim societies, as its institutional structure and operational mechanisms, rooted in the values of inclusion and social solidarity, enable broader outreach to

the most vulnerable groups (Mohamed & Fauziyyah, 2020). Nadeem et al. (2024), Billah et al. (2024), and Saad et al. (2025) demonstrate that, although both conventional and Islamic microfinance have positive effects on poverty reduction, Islamic microfinance tends to be more effective because it does not impose interest-based charges, thereby strengthening its impact on household welfare. Similarly, Asmawati and Ahmad (2017) find that participation in Islamic microfinance programs significantly increases clients' income and reduces poverty levels before and after financing, providing strong empirical support for the effectiveness of Sharia-based financing models in the Indonesian context.

The Role of Sharia Contracts and Risk-Sharing Mechanisms

One of the principal findings of this study is that profit-sharing contracts (mudharabah and musyarakah) have a greater impact on poverty reduction and household welfare improvement than sale-based contracts (murabahah). This finding supports the theoretical argument that risk-sharing mechanisms are more effective in microenterprise contexts, where income uncertainty is relatively high. Under profit-sharing arrangements, business risks are shared between BMTs and their clients, thereby alleviating financial pressure on low-income households and encouraging more productive entrepreneurial decision-making. This evidence contributes to the Islamic microfinance literature by demonstrating that the design of financing contracts is not merely a matter of legal or Sharia compliance, but also a critical determinant of the social effectiveness of Islamic financial institutions.

Saleem et al. (2024) argue that risk-sharing mechanisms in Islamic microfinance are more effective than sale-based contracts in achieving sustainable poverty reduction. Similarly, Hussein Kakembo et al. (2021) demonstrate that risk-sharing–based products enhance income stability and microenterprise resilience, thereby reducing households' economic vulnerability. Danlami et al. (2022) find that mudharabah and musyarakah contracts significantly improve microenterprise performance and alleviate household debt pressure among low-income households compared with lease- or sale-based financing arrangements. Complementary evidence from Hamdan et al. (2023) indicates that risk-sharing mechanisms increase client participation and produce superior business outcomes relative to interest-based or sale-based financing models. Rahaman et al. (2024) find a positive association in Bangladesh between profit-sharing contracts and income growth, as well as reductions in multidimensional poverty. Youssef (2025) further emphasizes that clients using mudharabah contracts demonstrate a greater capacity to smooth consumption and stronger resilience in business investment, as financial institutions and clients share business risks.

Integration of Islamic Social Finance and Multidimensional Welfare

This study further underscores the importance of integrating commercial financing with Islamic social funds, such as zakat, infaq, and sadaqah, within the institutional model of BMT. Access to these funds has been shown to generate significant additional effects in reducing poverty and strengthening household financial resilience. They serve as a buffer, protecting households from default risk, income volatility, and non-productive economic shocks, including illness and natural disasters. Consequently, BMTs function not merely as financial intermediaries but also as social institutions that establish community-based safety nets. This finding reinforces the multidimensional approach to poverty and demonstrates that partial or exclusively financial interventions tend to be less effective than integrated socio-commercial models in addressing the complex vulnerabilities faced by poor households.

This study underscores the importance of integrating commercial financing with Islamic social funds—namely, zakat, infaq, and sadaqah (ZIS)—within the BMT institutional model. This integration can significantly reduce poverty and strengthen household financial resilience. Empirical evidence

The harmonization of public social spending and ZIS substantially enhances human development and social welfare, producing greater impacts than the partial contribution of each funding source in isolation (Herlin et al., 2025). Panel studies conducted in Java reveal that ZIS contributes to reductions in multidimensional poverty while simultaneously supporting regional economic growth (Siregar et al., 2025). At the national level, further evidence confirms the significant role of ZIS in poverty alleviation (Ma'arif et al., 2025). Moreover, integrative approaches that combine Islamic social finance and microfinance services improve financial inclusion and economic capacity among ultra-poor populations (Tabarik & Alfarezel, 2025). Nevertheless, more coordinated distribution strategies remain necessary to maximize the welfare impacts of ZIS (Ayati et al., 2025). Furqon et al. (2024) and Widiastuti et al. (2022) argue that integrating Islamic social funds with financial services, including Islamic microfinance, substantially amplifies the socioeconomic impact of institutions such as BMT.

Impact on Household Welfare and Microenterprise Sustainability

The regression results indicate that BMT financing has a positive and statistically significant effect on income stability, consumption stability, financial resilience, and microenterprise sustainability. These findings suggest that Islamic microfinance not only generates short-term income gains but also strengthens households' economic foundations over the medium and long term. Microenterprise sustainability emerges as a key transmission channel through which BMT financing affects household welfare. Households receiving sustained financing and business support are more likely to maintain and expand productive enterprises, thereby contributing to local job creation and reducing structural poverty.

(Putra et al., 2024); (Azim et al., 2024); (Wulansari, 2025); (Saad et al., 2025); (Mahera et al., 2025) conclude that Islamic financing extends beyond short-term income enhancement by strengthening social capital, enterprise resilience, and financial inclusion. These mechanisms align with the role of Baitul Maal wa Tamwīl (BMT) in generating positive effects on income stability, consumption stability, and the long-term sustainability of microenterprises.

6. CONCLUSION AND SUGGESTION

Conclusions

This study examines the role of Islamic microfinance, particularly through Baitul Maal wa Tamwīl (BMT), in alleviating poverty and improving the welfare of beneficiary households. Drawing on empirical analysis and qualitative inquiry, the findings indicate that BMT-based Islamic microfinance is an effective instrument for poverty alleviation and for enhancing household welfare across multiple dimensions.

The results indicate that BMT financing not only reduces income poverty but also significantly alleviates multidimensional poverty across education, health, and living standards. Accordingly, the first research objective—to assess the impact of BMT financing on poverty—has been empirically validated. Furthermore, BMT financing enhances household welfare by strengthening income and consumption stability, improving financial resilience, and supporting microenterprise sustainability, thereby fulfilling the second research objective.

More importantly, this study demonstrates that the effectiveness of Islamic microfinance depends not only on the scale of financing but also on its institutional design and normative characteristics. Profit-and-loss-sharing contracts and the integration of Islamic social funds emerge as key mechanisms distinguishing the impact of BMT from that of conventional microfinance models. These findings reinforce the principles of Islamic economics by demonstrating that risk-sharing, social justice, and community solidarity have tangible empirical implications for household welfare. Consequently, this study provides robust evidence that Islamic microfinance is a relevant and viable policy instrument for advancing the Sustainable Development Goals.

Recommendations

Several recommendations emerge from this study. For policymakers, strengthening the Islamic microfinance ecosystem should extend beyond simply increasing financing volumes and instead focus on Developing BMT models that sustainably integrate productive financing with Islamic social funds is essential. Regulatory support, institutional incentives, and enhanced coordination among BMTs, BAZNAS, and local governments are necessary to strengthen the poverty-alleviation impact of Islamic microfinance initiatives. For BMT practitioners and managers, increasing the proportion of profit-and-loss-sharing contracts while strengthening microenterprise mentoring and business-development support is strongly recommended to maximize long-term welfare outcomes and enterprise sustainability among beneficiaries. Community-based approaches that respond to local socioeconomic conditions should continue to be refined and institutionalized. Future research should employ longer-term longitudinal designs or quasi-experimental approaches to strengthen causal inference. In addition, incorporating nonmaterial dimensions of welfare, such as social cohesion, empowerment, and spiritual well-being, would enrich understanding of Islamic microfinance within a holistic Islamic development framework.

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