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The Role of Customer-focused Strategies to Improve Islamic Microfinance Institutions Performance: Empirical Evidence and Lessons from Yemen

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ABSTRACT

Microfinance, a tool to fight poverty and to promote economic development, has attracted the attention of governments, international organizations, and academicians across the globe. Although the literature provides substantial evidence on the significant effects of the customer-focused strategies such as Total Quality Management (TQM) and Market Orientation (MO) on organizational performance, research on the role of these factors in the context of microfinance is still too limited, and in the field of Islamic microfinance is even more neglected. Moreover, empirical research related to these factors has shown that the findings are not conclusive, indicating the need for further research in the area. Thus, this study aims at examining the roles of TQM and MO on Islamic Microfinance Institutions (MFIs) performance in Yemen which provides additional insights into the literature. Cross-sectional survey was employed, and questionnaires were administered to collect data from the branch managers of Islamic MFIs in Yemen. Out of 93 questionnaires distributed through a self-administered approach, 71 usable responses were used for the analysis. Partial least square-structural equation modeling was used and the results provide an empirical evidence of the significant roles of TQM and MO on the Islamic MFIs performance. The study is of great importance for academicians as it opens the door for further research into the area. It is also useful for practitioners as it provides empirical evidence on the significant roles of these strategies in achieving sustainability and better performance by Islamic MFIs in Yemen. These strategies are essential in establishing the platform for innovation to enable Islamic MFIs to develop and generate new Islamic financing products that satisfy Muslims entrepreneurs.

Keywords: Total Quality Management, Market Orientation, Islamic Microfinance Institutions Performance, Yemen
JEL Classifications: G21, L1, M3

1. INTRODUCTION

Generally, the microfinance institutions (MFIs), as one of the development institutions, have drastically emerged as a powerful and effective tool for fighting poverty with the objectives to serve the low income people who lack access to commercial banking system during the last few decades (Ledgerwood et al., 2013; Mersland and Strøm, 2014; Boateng et al., 2015). As means of meeting national and economic development goals, the MFIs have created new job opportunities, helped existing businesses to grow and diversify their core activities, empowered women and other minority groups and support start-up businesses (Pakdel and Monroy, 2010). In fact, the MFIs have played important roles in reducing poverty and they are often regarded as one of the crucial mechanisms in promoting the economic and national development agenda (Ali and Alam, 2010). Islamic microfinance has been acknowledged to be an important part of the financial system as it is a key alternative tool for providing financial services to millions of poor Muslims who struggle to avoid financial services that do not comply with the sharia law. According to Obaidullah and Tariqullay (2008), it is estimated that 650 million Muslims live on less than $2 a day and are in need of Islamic microfinance products. The most common Islamic microfinance products are *Murabaha, Musharaka, Mudaraba, Istisna`a* and *Qard al Hassan*.

Islamic microfinance system is different from the conventional microfinance system as it prohibits the application of *Riba* or interest rate. The high interest rate imposed by conventional MFIs is believed to be a great obstacle to the development of the living standard of poor Muslims and other benefits (Alshebami and Khandare, 2014). Thus, Islamic microfinance services should be improved to meet the needs of poor Muslims customers. The services should be offered at reasonable cost in order to participate in eradicating poverty in the Muslims societies effectively.

In a conservative Muslim country like Yemen, it is argued that there is a promising market for Islamic microfinance products as 99% of the population are Muslims who are not in favor of dealing with the conventional financial institutions (Mansour, 2011). According to Alshebami and Khandare (2014), there are more than two million potential clients are in need of microfinance services in the Yemeni market, and at present only 3% of this market is covered. The MFIs were observed to be very weak and underperforming in terms of financial sustainability and in their outreach programs (Al-Shami et al., 2013). It was also reported that the financial self-sufficiency is about 97%, operational self-sufficiency is 98% and return on assets is 0.3%. These scores were low compared to the Arabic benchmark of 119%, 107% and 2.4%, respectively (Cordier et al., 2010). The Economist Intelligence Unit (2013) had also reported that only 7% of Yemenis have bank accounts and there is potential for a high demand for Islamic financial services that make microfinance intervention needed.

It was argued that the failure of the Yemeni MFIs can be attributed to the lack of market-oriented products and inappropriate strategies (Alshebami and Khandare, 2014). The service quality programs introduced by MFIs do not meet the clients' demands because they adopt the concept of "one size fits all," in the matter of services rather than providing a wide range of services (Burjorjee and Jennings, 2008). The interest rate is also the highest in the Arab region, for example, for 2008; it was 11% compared to 1.90% in Palestine, 3.70% in Morocco, 6.70% in Sudan and 7.60% in Jordan (Cordier et al., 2010). According to IFC Report (2007), lack of qualified and well-trained staff and the absence of professionalism and appropriate strategies were amongst the obstacles faced by the MFIs to reach their target clients. Mansour (2011) also mentioned several issues facing Yemeni MFIs such as weak institutional capabilities and lack of strategic outlook. This indicates that the lack of customer-focused strategies is among the reasons for the poor performance of MFIs in Yemen.

Among the most well-known organization strategies, Total Quality Management (TQM) and Market Orientation (MO) have been confirmed to provide a basis of competitive advantage for firms (Irfan and Kee, 2013; Rojas-Méndez and Rod, 2013; Kaur and Sharma, 2014; Julian et al., 2014). It was also argued that there is a mutual need for these two management practices to be implemented together as they complement each other because they focus on the customers' demands and satisfaction (Demirbag et al., 2006; Wang and Chen, 2011, Wang et al., 2012). Moreover, the majority of studies related to these factors were carried out in developed and developing countries, only a few studies have been conducted in the context of least developed countries particularly Yemen.

Based on the prior discussion, this study aims at examining the effect of TQM and MO on Islamic MFIs in Yemen. This study hopes to provide new insights into these relationships in the Islamic microfinance sector.

2. LITERATURE REVIEW

2.1. Islamic Microfinance Performance

The performance of MFIs has become a major issue as it ensures the effective utilization of the funds injected by donors and helps the regulators in controlling and monitoring these institutions (Mustafa and Saat, 2013). There is a consensus that the main objective of MFIs establishment is to eradicate poverty, therefore the sustainability of these institutions must be ensured (Zerai and Rani, 2012). According to Bassem (2012), the performance of MFIs is basically viewed from the perspectives of two major schools of thought, which are the welfarist school and institutionalist school. The welfarist school suggests that the focus should be given to the effects on the poverty level of the MFIs customers when measuring the performance of these institutions. Different measures such as the household income, expenditure on healthcare, clothing, water supply and the quality of a dwelling house are used to investigate the impacts of MFIs on the welfare of MFIs customers (Ghalib et al., 2011). On the other hand, the institutionalist school posits that the sustainability and ability to more poor people is the main concern of MFIs. Thus, the focus is given to different measures such as profitability, sustainability and efficiency (Roy and Goswami, 2013).

In this study, the balanced scorecard measurement system is used to evaluate the performance of Islamic MFIs operating in Yemen. This measurement system is recommended to be used for measuring MFIs performance by many scholars such as Koveos and Randhawa (2004), Waweru (2010), Waweru and Spraakman (2012), and Kipesha (2013). Their argument is based on the need to a measurement that must cover the dual objectives of MFIs, profit and social objectives. This model is comprised of five aspects: (i) financial aspect, (ii) customers, (iii) internal process, (iv) learning and growth, and (v) social aspect for measuring Islamic MFIs performance.

2.2. TQM and Islamic Microfinance Performance

Currently, quality has become a major concern for organizations in achieving success and competitive advantage in the market (Ghadiri et al., 2013). The concept of quality is viewed as the extent to which the products and/or services provided by organizations is consistently value-added and excellent to meet customer satisfaction (Homaid et al., 2015). The fierce competition and the increased demand for products and services with high quality by the customers have forced organizations to adopt the quality concept in their business models in order to satisfy the customers (Lam et al., 2011). In order to accomplish that, "quality vision" has to be incorporated into the firm's objectives and goals (Talib et al., 2011). Quality should be viewed as the generating value by improving every aspect of the firm continuously (Gharakhani et al., 2013), so as to satisfy both customers' and stakeholders alike (Kumar et al., 2009). This shows that the organizations strive to implement the quality strategy so as to meet the demands of their

customers and then gaining success and competitive advantage in the market.

According to Talib and Rahman (2010), the successful Total Quality Management (TQM) implantation requires selecting and ranking TQM practices. This is because TQM practices vary from organization to organization, from sector to sector and from country to country (Singla et al., 2011; Fryer et al., 2007). It is suggested that the number of TQM practices should range from 6 to 9 within the organizations (Talib et al., 2011). This is crucial especially when they adopt only few vital practices which rivals neglect so they satisfy customers and gain competitive advantage in the market (Talwar, 2011). Although there is a large number of TQM practices mentioned in the literature, there are some factors considered very important and common by TQM studies. In this study, seven practices are used, namely Leadership Management (LM), Customer Focus (CF), Strategic Planning (SP), Training (TR), Continuous Improvement (CI), Benchmarking (BM) and Quality Culture (QC) as suggested by Homaid et al. (2015) for the microfinance industry.

Empirically, the majority of studies which consider TQM as a holistic approach, confirmed its significant role on organizational performance such as Lam et al. (2011), Iqbal et al. (2012), Munizu (2013), Ul Hassan et al. (2013), Jiménez-Jiménez et al. (2015), Homaid et al. (2015) and Al-Dhaafri et al. (2016). All these studies confirmed the significant link between TQM and organizational performance. Moreover, based on the Resource-Based View (RBV) theory, TQM is considered as a valuable resource that enhances performance and drives an organization to achieve a sustainable competitive advantage (Idris, 2011). Whilst many firms have adapted and implemented TQM practices in their operations, the TQM creates an adequate environment where organizations become committed to customer satisfaction through IC which results in superior performance (Bayraktar et al., 2008; Munizu, 2013).

In general, the conclusions derived from the TQM and organizational performance literature indicates that there is a significant and positive relationship between them (Sila and Ebrahimpour, 2002; Nair, 2006; Jiménez-Jiménez et al., 2015). Thus, the following hypothesis was formulated:

Hypothesis 1 (H_1): TQM has a significant positive effect on the Islamic MFIs performance.

2.3. MO and Islamic Microfinance Performance

The concept of marketing is seen as organizational willingness to identify, understand the customer's needs and modify the marketing mix elements to satisfy these needs and demands (Houston, 1986). According to Sin et al. (2003), the marketing concept consists of three main pillars: (i) Customer philosophy (determination and satisfaction of the needs and demands of target customers), (ii) goal attainment (accomplishment of an organization's goals via satisfying customer needs and (iii) integrated marketing organization (integration of all functional areas of the organization to achieve corporate objectives by satisfying the demands and needs of customers). Osarenkhoe (2008) suggests that market-oriented organizations can apply a customer-intimacy which defines special organizational culture that takes into account the customer at the center of the organization's thinking in strategy and operations. This indicates that the marketing concept is a business philosophy which is widely accepted and applied in every aspect of an organization's operations.

The concept of Market Orientation (MO) is mainly used to refer to the application of marketing concept within the organization to obtain success and competitive advantage (Kohli and Jowarski, 1990). They defined MO as "the organization-wide generation of market intelligence pertaining to current and future needs of customers, dissemination of intelligence within an organization and responsiveness to it." With this definition, MO can be measured and operationalized through three constructs namely Intelligence Generation (IG), Intelligence Dissemination (ID), and Responsiveness (RE) to market intelligence. MO facilitates an organization's ability to anticipate customer needs, react quickly to satisfy customers and adapt to environmental changes, herewith, leading to superior performance (Mahmoud and Yusif, 2012).

Literature review reveals that there are several research works which provided evidence on the significant effect of MO on organizational performance such as Wang et al. (2012), Zebal and Goodwin (2012), Boso et al. (2013), Protcko and Dornberger (2014) and Al-Ansaari et al. (2015). According to the RBV theory, MO is a source of competitive advantage and superior performance within the firm (Kumar et al., 2011; Liao et al., 2011). This is due to the notion that market-oriented organizations have the ability to identify and anticipate customers' needs, take quick actions to meet these needs and adapt to the changes in the environment resulting in superior performance and competitive ability. On the basis of the preceding discussions, the following hypothesis is postulated:

Hypothesis 2 (H_2): MO has a significant positive effect on the MFIs performance.

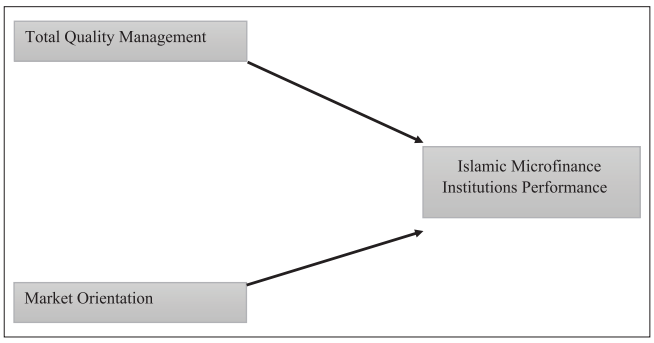
Based on the literature review, the theoretical framework of the study suggests that the greater the application of TQM and MO, the better is the performance of Islamic MFIs. Figure 1 displays the theoretical framework of the study.

3. METHODOLOGY

3.1. Data and Measurements

The sample in the study was selected from the Islamic MFIs in Yemen. The candidates (branch managers of Islamic MFIs)

Figure 1: The theoretical framework



were contacted and requested for their participation in the study. Altogether there were 93 branch managers of MFIs. Survey questionnaires were sent to the branch managers, and 73 usable questionnaires were returned and subsequently used in the data analysis. The information gathered was analyzed by using the Statistical Package for the Social Science and the smart partial least square (SmartPLS) softwares.

The measurements of the variables used in this study (TQM, MO and MFIs Performance) were drawn from various studies found in the literature (Kaplan and Norton, 1996; Lam et al., 2011; Wang et al., 2012; Conca et al., 2004; Brah et al., 2000; Talib et al., 2013; Kohli et al., 1993). The measures used a 5-point Likert scale ranging from 1 "Strongly Disagree" to 5 "Strongly Agree."

3.2. Data Analysis

A two-stage approach was used to evaluate the research model of this study, (1) The evaluation of the outer or the measurement model, and (2) the evaluation of the inner or the structural model. The approach taken follows the suggestions by various authors, such as Valerie (2012), Henseler et al. (2009) and Hair et al. (2014). The evaluation of the outer or the measurement model was undertaken to examine construct validity and reliability. The evaluation of construct validity involves two criteria: Convergent validity and discriminant validity, whilst the assessment of reliability is obtained through Cronbach's alpha and Composite Reliability (CR) scores. The second stage of model evaluation, the inner or the structural model, was used to assess the model quality by examining the following criteria: R^2 value, the significant levels of the path coefficients, and the predictive relevance of the model. The testing of the hypothesized relationships was conducted by the SmartPLS 3.0 software using the bootstrapping algorithm.

3.3. Outer Model Analysis

According to Hair et al. (2011) and Valerie (2012), the criteria for the assessment of validity and reliability of measurement model (outer model) are tested through Indicator reliability, internal consistency reliability, convergent validity and discriminant validity. The indicator reliability is indicated by the squares of each of the outer loadings; 0.70 or higher is preferred (Hair et al. 2014). In order to test the internal consistency reliability, the CR and Cronbach's alpha indicators are used. The threshold value of both CR and Cronbach's alpha should be 0.70 or higher (Hair et al., 2011). For testing the convergent validity, the Average Variance Extracted (AVE) should be 0.50 or higher which is used as an indicator for adequate convergent validity (Hair et al., 2011; Valerie, 2012). Figure 2 and Table 1 show the indicator reliability, internal consistency reliability and convergent validity tests results.

For testing the discriminant validity, the square root of AVE should be compared with correlations of each latent construct as the requirement to show the discriminant validity of the study model (Hair et al., 2014). Table 2 shows that all the square root of the AVE values exceeded the correlations of each latent construct in the model indicating that the discriminant validity is confirmed.

3.4. Inner Model Analysis

The R^2 values, predictive relevance of the model and the level and significance of the path coefficients are used to evaluate the structural model (inner model) based on the suggestions of Chin (2010), Hair et al. (2011) and Valerie (2012). The R^2 value of Islamic MFIs performance is 0.33 in this study which is considered substantial (Cohen, 1988). It indicates that 33% of the variance in the Islamic MFIs performance is explained by the customer-focused strategies, TQM and MO. According to Fornell and Cha (1994), the cross-validated redundancy value should be more than zero to show the predictive quality of the model. For this study, the predictive power of the model is established as the value of cross-validated redundancy is more than zero. The values of R^2 and cross-validated redundancy are shown in Table 3.

In order to examine the hypothesized relationships among the variables of the study, bootstrapping algorithm was run by SmartPLS. The outcomes show that TQM is significantly

Figure 2: Item loadings and R^2 value

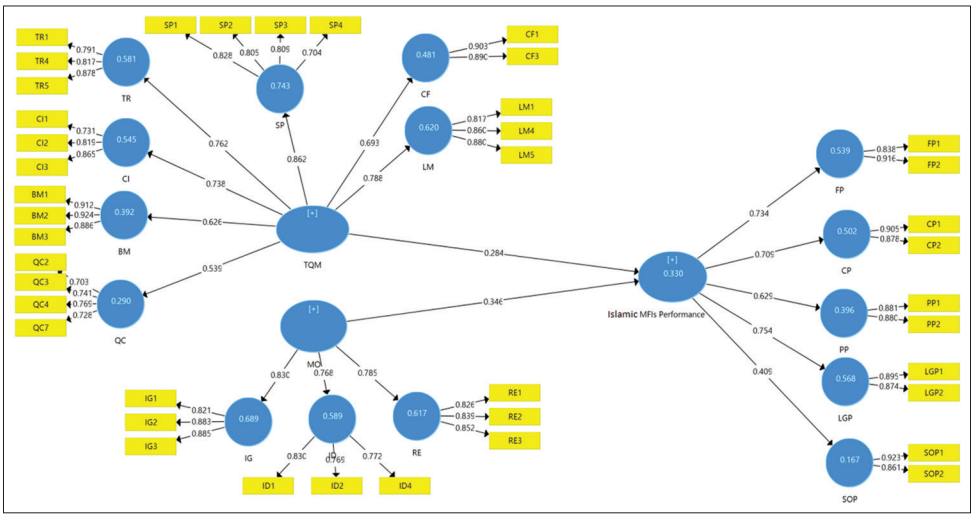


Table 1: Indicator reliability, internal consistency reliability and convergent validity tests

Construct	Items	Loadings	Cronbach's alpha	CR	AVE
Benchmarking	BM1	0.912	0.893	0.933	0.823
	BM2	0.924			
	BM3	0.886			
Customer focus	CF1	0.903	0.757	0.892	0.804
	CF3	0.890			
Continuous improvement	CI1	0.731	0.731	0.848	0.651
	CI2	0.819			
	CI3	0.865			
Customer perspective	CP1	0.905	0.743	0.886	0.795
	CP2	0.878			
Financial perspective	FP1	0.838	0.709	0.870	0.771
	FP2	0.916			
Intelligence dissemination	ID1	0.830	0.705	0.834	0.626
	ID2	0.769			
	ID4	0.772			
Intelligence generation	IG1	0.821	0.830	0.898	0.746
	IG2	0.883			
	IG3	0.885			
Learning and growth perspective	LGP1	0.895	0.724	0.878	0.783
	LGP2	0.874			
Leadership and management	LM1	0.817	0.812	0.889	0.727
	LM4	0.860			
	LM5	0.880			
Internal process perspective	PP1	0.881	0.709	0.873	0.775
	PP2	0.880			
Quality culture	QC2	0.703	0.721	0.825	0.541
	QC3	0.741			
	QC4	0.769			
	QC7	0.728			
Responsiveness	RE1	0.826	0.790	0.877	0.704
	RE2	0.839			
	RE3	0.852			
Social perspective	SOP1	0.923	0.750	0.887	0.797
	SOP2	0.861			
Strategic planning	SP1	0.828	0.795	0.867	0.621
	SP2	0.805			
	SP3	0.809			
	SP4	0.704			
Training	TR1	0.791	0.773	0.868	0.688
	TR4	0.817			
	TR5	0.878			

CR: Composite reliability, AVE: Average variance extracted

Table 2: Correlation and discriminant validity

Construct	BM	CF	CI	CP	FP	ID	IG	LGP	LM	PP	QC	RE	SOP	SP	TR
BM	0.907														
CF	0.244	0.897													
CI	0.324	0.450	0.807												
CP	0.186	0.262	0.333	0.892											
FP	0.344	0.171	0.167	0.463	0.878										
ID	0.398	0.364	0.405	0.306	0.354	0.791									
IG	0.323	0.329	0.451	0.248	0.230	0.469	0.864								
LGP	0.303	0.289	0.469	0.376	0.339	0.462	0.292	0.885							
LM	0.356	0.531	0.531	0.278	0.148	0.366	0.288	0.329	0.853						
PP	0.051	−0.012	0.163	0.199	0.330	0.267	0.075	0.448	−0.064	0.880					
QC	0.132	0.473	0.345	0.409	0.316	0.283	0.247	0.289	0.355	0.124	0.736				
RE	0.468	0.305	0.384	0.334	0.462	0.408	0.483	0.397	0.277	0.080	0.315	0.839			
SOP	0.181	0.021	0.308	0.173	0.184	0.086	0.227	0.185	0.201	0.108	0.177	0.190	0.893		
SP	0.518	0.565	0.638	0.351	0.264	0.438	0.489	0.366	0.712	0.001	0.316	0.419	0.254	0.788	
TR	0.607	0.437	0.479	0.224	0.393	0.511	0.378	0.434	0.454	0.157	0.274	0.516	0.264	0.574	0.829

BM: Benchmarking, CF: Customer focus, CI: Continuous improvement, CP: Customer perspective, FP: Financial perspective, ID: Intelligence dissemination, IG: Intelligence generation, LGP: Learning and growth perspective, LM: Leadership management, PP: Internal process perspective, QC: Quality culture, RE: Responsiveness, SOP: Social perspective, SP: Strategic planning, TR: Training

associated with Islamic MFIs performance at the 0.001 level ($\beta = 0.284$, $t = 2.904$, $P < 0.001$). Similarly, MO is significantly associated with Islamic MFIs performance at the 0.001 level ($\beta = 0.346$, $t = 3.152$, $P < 0.001$). This shows that both TQM and MO have positive and significant relationship with Islamic MFIs performance and therefore H_1 and H_2 of the study are supported. The results are displayed in Figure 3 and Table 4.

4. CONCLUSION AND DISCUSSION

This study sought to examine the effects of Total Quality Management (TQM) and Market Orientation (MO), customer-focused strategies, on the performance of Islamic MFIs in Yemen. The findings from this study provide support for the significant effect of these two strategies on the performance of Islamic MFIs. More specifically, both TQM and MO are shown to have positive and significant effects on Islamic MFIs performance at the significance level below 5%. The results are consistent with several studies on the TQM-organizational performance relationship (for example, Idris, 2011; Iqbal et al., 2012; Munizu, 2013; Homaid et al., 2015) and MO-organizational performance relationship (for example, Wang et al., 2012; Boso et al., 2013; Protcko and Dornberger, 2014; Al-Ansaari et al., 2015). The results support the suggestion that by adopting TQM practices and MO activities, the performance of Islamic MFIs is enhanced in terms of financial improvement, customer satisfaction, and operation process improvement, creating a suitable environment for learning and growth performance and achieving social goals. It can be concluded that the sustainability and continuity of Islamic MFIs to serve poor Muslims who are in need for their services can be attained by implementing TQM and MO strategies.

The results of the study provide evidence on the significant roles of TQM and MO as essential organizational strategies in fostering the performance of Islamic MFIs. Furthermore, the study also provides a useful guidance for TQM and MO implementation and assessment in Islamic MFIs operating in Yemen. Additionally, this study can also serve as a leverage to increase awareness of Islamic MFIs managers on the significance of TQM and MO in fostering the performance of their institutions. Particularly, they have to pay more attention to build the capabilities of their institutions by implanting TQM practices and MO activities in order to develop the existing Islamic financing models and provide innovative Islamic models to finance Small and Medium enterprises. Findings from other research have generally acknowledged that TQM and MO provide the necessary platform for inculcating innovation in organizations (Singh and Smith, 2004; Morgan, and Berthon, 2008). Therefore, international organizations, governments and other donors should provide technical assistance to Islamic MFIs such as financial grants and Training the staff in order to enable them implementing these strategies and then provide adequate services to Muslims.

Table 3: R^2 and cross-validated redundancy values

Variable	Variable type	R^2	Cross-validated redundancy	Cross-validated communality
MFIs performance	Endogenous	0.330	0.098	0.187

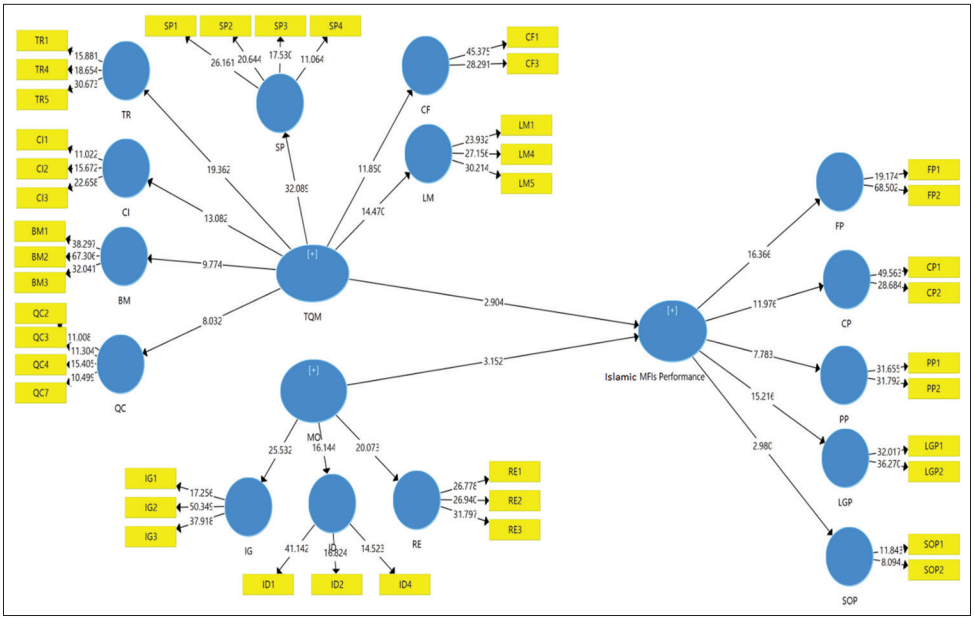
MFI: Microfinance institutions

Table 4: Hypothesis testing results

No.	Hypothesis path	Path coefficient	Standard error	t value	P value	Decision
H_1	TQM→Islamic MFIs performance	0.284***	0.098	2.904	0.000	Supported
H_2	MO→Islamic MFIs performance	0.346***	0.110	3.152	0.000	Supported

***P<0.001. TQM: Total quality management, MO: Market orientation

Figure 3: Significance of factor loadings and path coefficient



The results of this study were based on perceptual data provided by MFIs branch managers. There is a possibility that the findings may be generalizable to other similar sectors. As this study employed a cross-sectional research design, which involved collecting data at one point of time, it did not take into account the changes that may have occurred as a result of the changing environment in the market. Thus, future research should consider the possibility of studying other industries and also the use of other research designs. In addition, future research can also expand the current study by expanding the framework to include more TQM practices, and to study TQM practices as a multidimensional construct in order to examine the possibility of different effects of each practice on Islamic MFIs performance. Moreover, the current research framework can also be enriched by including other organizational resources or capabilities as independent variables, moderators and mediators which may provide new insights.

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