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COMPARATIVE ANALYSIS THE ROLE OF ISLAMIC AND CONVENTIONAL MICROFINANCE INSTITUTIONS IN SUPPORTING THE WELFARE OF ECONOMICALLY VULNERABLE COMMUNITIES

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Abstract

This study compares the performance of Conventional Microfinance Institutions (MFIs) and Sharia Microfinance Institutions (SMFIs) in supporting the welfare of economically vulnerable communities. The results show that SMFIs have an advantage in terms of social impact and financial inclusion for the poor, while MFIs excel in profitability and business expansion. However, both have different challenges in terms of liquidity stability and financial risk. This study recommends adaptive and inclusive policies, as well as optimizing the potential of social funds such as zakat, infaq, sadaqah, and waqf (ZISWAF) to support the sustainability of MFIs. Future research should further investigate the optimization of ZISWAF social funds in supporting the sustainability of microfinance institutions, analyze adaptive and inclusive policy models for both types of institutions, and evaluate strategies for improving liquidity stability and financial risk management.

Keywords: *Microfinance Institutions, Community Welfare, conventional vs sharia.*

INTRODUCTION

Microfinance institutions (MFIs) play a vital role in providing access to finance for vulnerable communities, who are often prevented from accessing formal banking services. MFIs aim to improve the welfare of low-income people through various services, such as loans and entrepreneurship training. Both conventional and sharia MFIs make important contributions to improving financial inclusion and reducing poverty, although they use different approaches (Riwajanti, 2013). In Indonesia, Islamic MFIs are preferred due to their principles that are in line with Islamic teachings that avoid the practice of interest, which is considered essential to achieve social justice. Research by Ahmad et al. (2020) also shows that Sharia MFIs have greater potential in creating social welfare, particularly by providing usury-free financial assistance (S. Ahmad et al., 2020).

Sharia MFIs in Indonesia, such as Baitul Maal wa Tamwil (BMT) and Islamic People's Financing Bank (BPRS), have demonstrated a strong role in empowering low-income communities through financing and community support services. Meanwhile, in Malaysia, institutions such as Amanah Ikhtiar Malaysia (AIM) have successfully provided Islamic-compliant financial support to poor communities and played an important role in improving their lives. This underscores that Islamic MFIs have a dual function: as financial service providers as well as social and spiritual mediators for the communities they serve.

On the other hand, conventional MFIs show an advantage in financial sustainability and profitability, enabling faster business expansion and wider access to financing. Noted that Bank Rakyat Indonesia (BRI), one of the largest conventional MFIs, has successfully expanded its services to remote areas by providing low-interest microcredit that supports small business development (S. Ahmad et al., 2020). Research by Fianto et al. (2018) shows that although conventional MFIs show higher efficiency in financial aspects, Islamic MFIs have a more significant role in reaching out to people who need social and moral support (Fianto et al., 2018).

Sharia microfinance is now recognized as an effective model in reducing poverty and boosting the economy. With fair, transparent and profit-sharing Islamic principles, it provides access to finance to low-income people, supports micro-enterprise growth, and improves overall economic welfare and performance (Kijkasiwat & Phuensane, 2020). Empirical studies show that Islamic microfinance has a significant impact on the performance of various strategic sectors, especially in improving the welfare of economically vulnerable people. This financing model has proven effective in supporting local economic growth and community empowerment, which plays an important role in reducing social and economic disparities in developing countries. With its fair sharia principles, profit-sharing system, and avoidance of usury, uncertainty, and speculation, Sharia microfinance helps vulnerable communities to access necessary capital without the burden of burdensome interest (Darwanto et al., 2019).

In Indonesia, the lack of success of Sharia microfinance, especially in supporting economically vulnerable communities, is due to several factors, including: (i) inappropriate financing analysis, which makes it difficult to predict potential problems during the loan period; (ii) limited knowledge of program implementers about the character and type of business of borrowers; (iii) borrowers who deliberately do not make installment payments due to moral hazard issues; (iv) too large business expansion due to weak business management; and (v) lack of effective mentoring and coaching processes (Rahman et al., 2017).

The Financial Services Authority (OJK) has established various regulations to govern both conventional and Islamic microfinance institutions (LKM). These include POJK No. 12/POJK.05/2014 on Licensing and Institutional Matters of LKM, POJK No. 13/POJK.05/2014 on the Operation of LKM, and POJK No. 14/POJK.05/2014 on LKM Supervision and Guidance. These regulations address aspects such as minimum capital requirements, governance, risk management, and customer protection. For Islamic LKM, additional provisions ensure compliance with sharia principles and oversight by a Sharia Supervisory Board. OJK also mandates that LKMs maintain a periodic reporting system, adhere to prudential principles in financing distribution, and maintain financial ratios in accordance with regulations to ensure operational health.

The advantages offered by Islamic microfinance include several important aspects, such as the avoidance of usury, the implementation of a profit-sharing system, and the promotion of fairness in line with sharia principles (Junjunan et al., 2022). In addition, this model also avoids uncertainty (gharar or taghrir) and speculation (maysir or qimar), which can often harm business actors. These sharia-based advantages are considered very appropriate in supporting the existence of microfinance, which requires a fair, transparent, and sustainable financing model. Thus, Islamic microfinance can provide a more balanced bargaining position for the economically vulnerable, allowing them to access the resources needed to improve their welfare and compete more effectively in an increasingly competitive market (Kijkasiwat & Phuensane, 2020).

Sharia Financial Institutions promote sharia principles in every product they offer, emphasizing the use of legal contracts in every transaction. These contracts include mudharabah or musyarakah contracts, which are usually used for financing or capitalization, as well as murabahah contracts used in sale and purchase transactions. In addition, it also offers various other financial products that are designed to comply with Islamic sharia provisions, such as consumptive and investment financing that does not involve elements of usury (Hidayati & Rusyadi, 2022).

In comparison, conventional financial institutions operate using a more flexible system of contracts or agreements, where these contracts become a condition for money lending activities. These contracts usually stipulate the payment of interest charged on loans given to customers, with the interest system as a profit for the institution. The interest system in conventional banks is considered incompatible with Islamic principles, which prohibit the practice of usury. Although the majority of Indonesia's population is Muslim, Islamic financial institutions have yet to attract much attention. Public interest in Islamic banks is relatively low, and their growth has not shown significant development. As a result, people tend to continue to choose conventional interest-based financial institutions over Islamic alternatives (Ramadhani & Habib, 2021).

By combining financial and social approaches, Islamic MFIs not only help economically but also strengthen the moral and spiritual dimensions of their clients. Sharia MFIs educate customers on the importance of responsible financial management, an aspect that distinguishes them from conventional financial institutions. Fianto et al. (2018) also found that this support strengthens customers' economic resilience as they are encouraged to utilize funds wisely, not only for consumption but also for sustainable investment (Fianto et al., 2018).

LITERATURE REVIEW

Indonesia as a large nation with good tolerance, a country that is able to combine a good religious spirit at the same time as being modern and still getting along with international levels with diverse backgrounds and religions, a country that has a character as an open country and is ready to make improvements towards a better direction. (Jahharudin, 2021). Sharia Microfinance Institution (SMFIs) is a micro-economic institution that collects funds and distributes financing to small communities, both social in nature such as zakat, infaq and alms or distribution and financing of business capital that is profit or profit with a profit-sharing system. Islamic microfinance institutions are one of the pillars in the financial intermediation process. Microfinance is needed by small and medium-sized communities for both consumption and production as well as saving the proceeds of their businesses.

Islamic microfinance institutions have an important role in strengthening the micro and small enterprise (MSME) sector, which is considered the backbone of the economy in many countries. According to the World Bank (2020), MSMEs account for about 50% of total global employment. By providing microfinance, training, and mentoring, Islamic microfinance institutions assist MSMEs in expanding their businesses, increasing productivity, and creating new jobs. This directly contributes to sustainable and inclusive economic growth. Islamic microfinance institutions also promote financial inclusion for marginalized communities.

Islamic financial institutions have characteristics that are not possessed by conventional financial institutions. These characteristics include: the existence of a Sharia Supervisory Board; the relationship between investors (depositors of funds), users of funds, and Islamic Financial Institutions as an intermediary institution based on partnerships, not the relationship between debtors and creditors; The business of Islamic Financial Institutions is not only based on profit oriented, but also falah oriented, namely prosperity in the world and happiness in the hereafter; Islamic financial institutions only make halal investments and do not cause harm (Ben Abdelkader & Mansouri, 2019). According to the directorate of financing (2004) Microfinance institutions were developed based on the spirit to help and facilitate the poor, both for consumptive and productive activities of these poor families (Alamgir et al., 2010).

As for the role of Islamic microfinance institutions, namely as poverty alleviation through community empowerment in microfinance institutions can break the chain of poverty, with this Islamic microfinance institutions act as financial service providers for people who have limited access to banks. Second, the role of Islamic microfinance institutions as economic equality with the opening of access to finance for the poor will be an alternative to providing justice and welfare for the poor, with this it will create economic equality for the community (S. Ahmad et al., 2020).

METHODOLOGY

This research uses a comparative qualitative method to analyze the role of Sharia Microfinance Institutions (SMFIs) and Conventional Microfinance Institutions (MFIs) in supporting the welfare of economically vulnerable communities. The data used in this study is secondary data, obtained through literature studies, annual reports, official statistics, as well as previous research relevant to the role, impact, and challenges faced by MFIs and CFIs. Ahmad (2022) and Mohd Thas Thaker et al. (2021) stated that secondary data helps researchers to understand the contribution of financial institutions to the economic welfare of the community from various perspectives. Therefore, secondary data in this study was collected from scientific articles, books, annual reports of microfinance institutions in Indonesia and Malaysia.

Data collection was conducted using document collection techniques, which involved in-depth search and review of relevant documents. This approach enables a deeper understanding of the role of MFIs and CFIs in the context of poverty alleviation, especially in providing access to finance to low-income communities (Mohd Thas Thaker et al., 2021). In addition, comparative literature analysis was used to identify differences in operational models, empowerment strategies, and challenges faced by both types of institutions. Thematic analysis was applied to find patterns and key themes such as social sustainability, access to finance, capital constraints, and direct and indirect impacts on the welfare of vulnerable communities (Masyita, 2017).

To increase the credibility of the data, this study used data triangulation by verifying information from various literature sources, as well as data validation techniques such as peer review to ensure the accuracy and relevance of the findings (Masyita, 2017). The use of this comparative qualitative approach is expected to provide an objective understanding of the effectiveness of MFIs in supporting the welfare of economically vulnerable communities, as well as contribute to future policy studies on the development of microfinance institutions.

RESULT & DISCUSSION

Financial Performance of Conventional Microfinance Institutions and Sharia Microfinance Institutions

In analyzing the financial performance of Conventional Microfinance Institutions (MFIs) and Sharia Microfinance Institutions (SMFIs), there are significant differences in the operational models and their impact on the financial stability of each institution. The financial statements show that each institution faces different challenges related to income sources and liquidity.

Financial Performance of Conventional Microfinance Institutions

Tabel 1. Conventional Cooperative MFIs Four Monthly Financial Performance (Billion Rupiah)

Items	April 2023	August 2023	December 2023	April 2024
A. Operational Revenue				
Interest Revenue	9,72	14,37	21,15	9,20
Other Operational Revenue	1,23	1,83	3,09	2,10
Total Operational Revenue	10,95	16,20	24,24	11,30
B. Operational Expense				
Interest Expense	1,77	2,29	2,87	1,61
Allowance for Elimination Loan	3,49	3,57	3,69	2,52
Fixed Asset and Inventory Depreciation Expense	0,34	0,59	0,57	0,31
Labor Expense	4,35	6,06	8,65	4,34
Other Operational Expense	1,78	2,88	4,69	1,64
Total Operational Expense	11,72	15,38	20,46	10,42
C. Operational Profit (Loss)	**(0,78)**	**0,82**	**3,78**	**0,88**
Non-Operational Revenue	0,16	1,14	1,17	0,15
Non-Operational Expense	0,07	0,20	0,31	1,04
D. Profit (Loss) Before Income Tax	**(0,69)**	**1,76**	**4,65**	**(0,00)**

Income Tax Estimation	0,02	0,04	0,06	0,03
E. Profit (Loss) After Income Tax	**(0,70)**	**1,72**	**4,59**	**(0,04)**

Source: Otoritas Jasa Keuangan (OJK)

Interest Income: In April 2024, interest income was recorded at IDR 9.2 billion, down from IDR 21.15 billion in December 2023. This significant decline may indicate a high dependence on fluctuating market interest rates. This may be due to external economic factors or the customer's ability to pay interest that is burdensome.

Other Operating Income: In addition to interest income, there was other operating income of IDR 2.1 billion in April 2024, which also decreased compared to IDR 3.09 billion in December 2023. This indicates a challenge in increasing additional sources of income other than interest.

Interpretation: A significant decline in interest income indicates a high risk for Conventional MFIs, especially if there is a decline in customer purchasing power or an increase in market interest rates. This high dependency on interest-based income increases the risk of income volatility, especially for economically vulnerable communities who are the main targets. This condition shows the need for diversification of income sources or other strategies to maintain operational stability.

Performance of Sharia Microfinance Institutions

Tabel 2. Conventional Cooperative MFIs Four Monthly Financial Performance (Billion Rupiah)

Items	**April 2023**	**August 2023**	**December 2023**	**April 2024**
A. Operational Revenue				
Murabahah Margin Revenue	7,53	15,31	22,75	7,94
Salam Revenue	0,00			
Istishna Margin Revenue				
Ijarah Revenue	1,37	2,80	4,64	2,28
Mudharabah Profit Sharing Revenue	0,62	1,26	1,56	0,54
Musyarakah Profit Sharing Revenue	0,93	1,99	2,93	0,88
Other Operational Revenue	6,18	12,07	18,37	7,78
Total Operational Revenue	16,63	33,43	50,24	19,41
B. Rights for Profit Sharing Third Party	2,00	4,08	5,93	2,35
C. Operational Revenue after Profit Sharing Distribution	14,63	29,35	44,31	17,07
D. Operational Expense				
Wadiah Bonus Expense	0,34	0,41	0,53	0,35

Labor Expense	6,25	11,83	17,12	7,50
Depreciation Expense	0,54	1,01	1,45	0,60
Allowance for Financing Elimination	1,90	2,74	5,50	2,08
Other Operational Expense	5,79	11,46	17,22	6,11
Total Operational Expense	14,82	27,44	41,83	16,65
E. Operational Profit (Loss)	**(0,19)**	**1,91**	**2,49**	**0,41**
Non-Operational Revenue	0,19	0,08	0,13	0,24
Non-Operational Expense	0,36	0,68	0,91	0,72
F. Profit (Loss) Before Income Tax	**(0,35)**	**1,30**	**1,71**	**(0,07)**
Income Tax Estimation	0,09	0,19	0,31	0,09
G. Profit (Loss) After Income Tax	**(0,45)**	**1,11**	**1,40**	**(0,16)**

Source: Otoritas Jasa Keuangan (OJK)

Murabaha Margin Income: As of April 2024, revenue from murabahah margin reached Rp7.94 billion, down from Rp22.75 billion in December 2023. Despite the decline, this margin-based income provides greater stability than interest-based income as it is not dependent on market interest rates and is more customized to the customer's repayment ability.

Salam Income: Revenue from salam contracts was insignificant in this period, with very low or nil revenue recorded in some months. This indicates that murabaha remains the main contract in the revenue structure of the Sharia Cooperative MFIs. Interpretation: Murabaha margin income provides greater stability and certainty of payment as the murabaha contract fixes the profit margin at the beginning of the agreement, reducing the uncertainty often experienced in interest-based income. This model is more suitable for economically vulnerable customers, as the Islamic approach provides flexibility and avoids usury. The decline in April 2024 may be due to financing demand factors or economic conditions affecting customer activity, but the impact is relatively more stable than fluctuations in interest.

Comparison of Income Between Interest and Margin in MFIs and SMFIs

In Conventional Microfinance Institutions (MFIs), the main revenue comes from interest charged to customers on loans. This model is common in conventional financial institutions, where interest is set according to market interest rates. However, the reliance on interest-based income poses risks, especially for customers in vulnerable economic groups. In unstable economic conditions, such as rising interest rates or high inflation, customers may find it difficult to pay interest, which in turn increases the risk of bad debts or defaults. On the other hand, Sharia Microfinance Institutions (MFIs) use a model that avoids interest (riba) and switches to margins or profit sharing. In a murabahah contract, for example, the MFI buys the goods needed by the customer and then resells them at a pre-agreed price that includes a profit margin. Since the amount of this margin is fixed upfront, the customer knows the total payment amount from the start of the agreement. This makes the Islamic model more flexible and stable in volatile economic conditions, as it is not affected by changes in interest rates.

The advantage of this profit-sharing and margin model is transparency and certainty in payments which reduces the burden on the customer. A study by Mohd Thas Thaker et al. (2021) states that the Islamic approach through murabaha margins is "more in line with the economic needs of low-income people" and is able to provide a sense of justice because it does not burden customers with additional fluctuating interest. In contrast, the interest model in conventional financial institutions focuses on the profit of the financial institution and pays little attention to long-term stability for vulnerable customers (Document). The sharia model also provides flexibility for MFIs to adjust the payment scheme according to the customer's ability, which according to (Jimoh et al., 2024), helps improve financial inclusion for the poor. MFIs that apply sharia principles such as murabaha and other contracts provide support not only in the form of capital but also guidance and education to customers, so that they not only get funds but also get the knowledge to manage their finances independently.

Liquidity Stability and Cash Management

Conventional Microfinance Institutions (MFIs) and Sharia Microfinance Institutions (SMFIs) have fundamental differences in terms of liquidity stability and cash management. MFIs tend to face greater fluctuations in cash availability due to reliance on interest-based income that can change according to market conditions and interest rates. When economic conditions are unstable, such as when interest rates rise, MFIs may experience a decline in liquidity as customers may find it more difficult to meet their obligations. This also has an impact on the limitations of MFIs in providing new loans or capital to other customers, thus reducing their effectiveness in supporting the welfare of vulnerable communities (Jimoh et al., 2024). In contrast, MFIs show better liquidity stability because they apply sharia principles in their financial management, such as murabahah and profit-sharing contracts. These contracts provide certainty of the amount paid by the customer at the beginning of the agreement without being affected by changes in interest rates. Based on (Masyita, 2017) research, this Islamic finance model allows MFIs to manage liquidity more stably and sustainably. With a more secure amount of cash and income, MFIs can remain active in channeling financing or capital to vulnerable communities, despite unstable market conditions.

In addition, the placement of funds in savings or other forms of assets in SMFIs is also more regular, as seen in the increase in cash and stability of fund placement in some SMFIs. According to research by Amsami et al. (2021), MFIs that manage cash according to sharia principles are more resilient to macroeconomic changes, such as inflation or recession, that affect market conditions. This allows MFIs to continue operating with stable liquidity so that they can continue to support customers' financial sustainability and provide them with consistent access to sources of financing. MFIs also prioritize aspects of financial management that not only aim for profitability, but also social welfare through the mechanisms of zakat, sadaqah, and qard al-hasan. These schemes provide flexibility in managing liquidity with the aim of maintaining a financial balance that benefits customers without burdening them. This approach helps maintain liquidity stability while supporting sustainable customer welfare (Uddin.et.al 2020).

Financial Risk and its Impact on Vulnerable Communities

Conventional Microfinance Institutions (MFIs) and Sharia Microfinance Institutions (SMFIs) face different financial risks, especially in supporting vulnerable communities. MFIs that rely on interest income are more vulnerable to market risks, especially during changes in interest rates or economic downturns. If interest rates increase, the cost of borrowing also increases, which can burden low-income clients and increase the potential for bad debts. When customers are unable to repay loans with high interest rates, MFIs experience a decrease in liquidity that affects operational stability (Maulina et al., 2023).On the other hand, MFIs face lower risks due to the profit-sharing and margin models applied in Islamic contracts, such as murabahah, which avoid usury. In a profit-sharing contract, the risk is shared between the institution and the customer, so if the customer's business experiences difficulties, the burden is not fully borne by the customer. This model helps lower the risk of default for financially vulnerable customers and provides a sense of fairness in financing. According to research by Mohd Thas Thaker et al. (2021), this profit-sharing model allows MFIs to support clients without adding excessive debt burden, thus creating greater stability in the long run.

In addition, sharia-based MFIs have social financing mechanisms such as zakat and qard al-hasan, which act as interest-free bailouts for customers who need assistance. According to Ahmad (2022), these mechanisms not only help reduce the risk of default, but also increase financial inclusion by opening access for the poor to obtain funds without worrying about interest obligations. The presence of zakat and interest-free financing is also the main differentiator between MFIs and MFIK, where MFIs are able to provide financing without burdening customers who are unable to pay. This model is considered effective in expanding access to finance for vulnerable groups without increasing high financial risks for both the institution and its customers (Masyita 2017).

Effectiveness in Supporting Socio-Economic Welfare

Conventional Microfinance Institutions (MFIs) and Sharia Microfinance Institutions (SMFIs) contribute to the welfare of economically vulnerable communities, but with different approaches in achieving social and economic impact. MFIs focus on profitability and efficiency through an interest-based financing system, aiming to rapidly increase access to finance. However, this model often does not consider the social aspects and long-term welfare of low-income communities. According to research by (Uddin et al., 2020), profit-oriented MFIs are more at risk of worsening the already vulnerable economic situation of clients due to the additional interest burden, so their social impact is relatively limited and more focused on achieving the financial goals of the institution. With this approach, MFIs act not only as capital providers but also as agents that reinforce moral, social and spiritual values. A study by Mohd Thas Thaker et al. (2021) found that MFIs are "more effective in providing long-term positive impacts on people's socio-economic welfare" as they provide financing that is not only customer-friendly, but also prioritizes sustainable and inclusive economic growth.

In addition, MFIs often complement their financial services with financial education and training programs that help customers manage funds wisely and independently. Research by Wediawati & Setiawati (2016) shows that MFIs that offer entrepreneurship and financial literacy training can improve customers' skills in managing micro businesses. In addition, the presence of social funds such as zakat and qard al-hasan in MFIs allows the poor to gain access to interest-free financing. This promotes more holistic social and economic welfare, reduces dependency on profit-oriented institutions, and creates a more inclusive impact on society. Thus, the sharia approach applied by MFIs shows a broader impact in improving the economic welfare of vulnerable communities (Amsami et al., 2021).

Challenges in Development and Sustainability

In their efforts to support economically vulnerable communities, both Conventional Microfinance Institutions (MFIs) and Sharia Microfinance Institutions ("SMFIs") face challenges in terms of development and sustainability. MFIs face a major challenge in the form of the need to diversify their sources of income so that they are not entirely dependent on interest. This dependency makes MFIs more vulnerable to changes in interest rates and fluctuating economic situations, which can negatively impact the financial stability of the institution. According to research by (Mohd Thas Thaker et al., 2021), "the high dependence on interest-based income requires MFIs to seek more flexible revenue models in order not to burden customers and maintain long-term sustainability".In addition, MFIs face challenges in terms of more limited access to capital, as the interest-averse Islamic model attracts fewer investors than the conventional model. Many MFIs still rely on government subsidies or donor funds to maintain operations, especially in rural and remote areas. In this case, MFIs often find it difficult to expand heavily or develop new financial services to attract more customers.

To overcome this challenge, MFIs need to develop more effective strategies in utilizing the potential of zakat, infaq, sadaqah, and waqf (ZISWAF) as a sustainable source of funding. With the support from these funding sources, MFIs can expand their services to the poor without relying too much on external investors. According to (Masyita, 2017), ZISWAF funds play an important role in improving the ability of MFIs to provide financing without burdening customers, as well as ensuring that the funds used directly contribute to the welfare of vulnerable communities. In addition, improving the quality of human resources is also an important challenge for MFIs in maintaining sustainability. Effective management of MFIs requires in-depth knowledge of the principles of Islamic finance, as well as the ability to manage risks that are different from MFIs (Maulina et al., 2023).

Macroeconomic Impact on the Performance of MFIs and SMFIs

The performance of Conventional Microfinance Institutions (MFIs) and Sharia Microfinance Institutions (SMFIs) is strongly influenced by macroeconomic conditions. Changes in interest rates, inflation, and economic growth rates are external factors that affect their operational stability. MFIs, which rely heavily on interest-based income, are more vulnerable to interest rate increases that cause customer payment burdens to increase. This condition often leads to increased risk of bad debts and decreased profitability of the institution. According to research by Setiawan (2016), "the performance of MFIs is very sensitive to interest rate fluctuations, which makes them less stable especially in the face of economic uncertainty. "In contrast, MFIs that avoid the use of interest are more protected from the risks posed by interest rate fluctuations. Shariah-based financing systems, such as profit-sharing and murabaha, provide more flexibility in adjusting customers' payment schemes according to their capabilities. In addition, this model also ensures that the risk is shared between the institution and the customer, so the impact on the stability of the institution is more manageable compared to MFIs. Noor Azmi & Thas Thaker (2020) note that "MFIs tend to be more resilient to macroeconomic shocks due to their financial structure that is not affected by market interest rates."

However, although MFIs are more stable in the face of interest rate fluctuations, macroeconomic challenges such as inflation and recession can still affect financing demand and customer repayment ability. Research by Masyita (2017) shows that high inflation rates can reduce customer purchasing power and demand for financing in both MFIs and SMFIs. This condition requires adaptive strategies from both types of institutions to maintain operational sustainability, such as the development of financial products that meet the needs of customers in difficult economic conditions. In addition, the overall economic growth rate also plays an important role in determining the success of MFIs and SMFIs. Under high economic growth conditions, both MFIs and FIs tend to experience an increase in financing disbursement and profitability. However, in an economic slowdown, SMFIs have an advantage through their sharia approach which is more oriented towards community welfare than just profitability (Iqbal & Mirakhor, 2012). According to Kassim & Satar (2019), this approach helps SMFIs remain relevant in providing financing to the community despite facing tough macroeconomic challenges.

CONCLUSION

This research shows that Islamic microfinance institutions (MFIs) and conventional microfinance institutions (CMBs) have significant contributions in supporting the welfare of economically vulnerable communities, but they have fundamentally different approaches. MFIs use financing models based on sharia principles, such as murabaha and profit-sharing contracts, which avoid interest (riba) and provide a more stable margin or profit-sharing. This model not only provides payment certainty for customers but is also more suitable for vulnerable communities that are sensitive to economic changes, as it is not affected by fluctuations in market interest rates. In contrast, MFIs apply an interest-based financing model that is flexible to market interest rates, which makes them more vulnerable to economic uncertainty but more profitable in terms of profitability. In terms of liquidity stability and financial risk, MFIs are superior due to the application of the sharia model that maintains liquidity stability and reduces the risk of bad debts in the midst of unstable economic conditions. SMFIs also have social financing mechanisms, such as zakat and qard al-hasan, which can support customers without adding financial burden.

On the other hand, MFIs face greater liquidity risk, especially when market interest rates increase or under unfavorable economic conditions, which increases the probability of bad debts among vulnerable clients. In terms of social and economic impact, MFIs show a broader contribution not only as capital providers but also as agents that reinforce moral and social values through entrepreneurship education and training for clients, thus supporting the overall empowerment of the poor. Meanwhile, MFIs, while having a broader scope and greater access to capital, are more focused on financial returns, hence their social impact is more limited. However, both institutions face different operational challenges. MFIs face limitations in access to capital as well as qualified human resources, as the interest-averse Islamic model is less attractive to most investors than the conventional model. Many MFIs rely on social funds or government subsidies to sustain their operations, especially in rural areas. On the other hand, MFIs need to diversify their income sources to avoid relying solely on interest which is vulnerable to economic changes.

To strengthen their impact, this study recommends adaptive and inclusive policies, encouraging collaboration between SMFIs and MFIs, and optimizing the potential of social funds such as zakat, infaq, sadaqah, and waqf (ZISWAF) to support the sustainability of SMFIs. Improving the capacity of human resources in SMFIs is also important in order to compete with conventional institutions as well as the development of financial products that are more suitable for vulnerable communities. SMFIs and MFIK have their own advantages and challenges, with SMFIs excelling in terms of social impact and financial inclusion for the poor, while MFIK excels in profitability and business expansion. It is hoped that the synergy between the two will be able to effectively and sustainably expand access to finance for vulnerable communities, and support more inclusive economic growth.

Based on the research findings, several practical recommendations for the development of conventional and Islamic microfinance institutions (LKM) include: (1) Strengthening capital through strategic partnership schemes with commercial banks and larger financial institutions; (2) Developing innovative financial products that combine commercial and social aspects, such as group financing and profit-sharing-based financing; (3) Enhancing human resource capacity through training programs in risk management, governance, and digital financial literacy; (4) Optimizing digital technology for operational efficiency and expanding service reach; (5) Specifically for Islamic microfinance institutions, optimizing the integration of ZISWAF funds into microeconomic empowerment programs through collaboration with zakat and waqf management institutions; and (6) Strengthening supervision and reporting systems to ensure compliance with OJK regulations and prudential principles in financing distribution.

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