

# Analysing *ar-rahnu* in the context of informal credit market theory

## Evidence from women micro-entrepreneurs in Malaysia

Analysing  
*ar-rahnu*

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### Abstract

**Purpose** – This study aims to offer a new area of discourse by investigating the factors determining the usage of the Islamic non-bank financing product *ar-rahnu* (Islamic pawnbroking) among women micro-entrepreneurs in Malaysia within the framework of the informal credit market theory.

**Design/methodology/approach** – The study is based on primary data obtained by using self-administered questionnaires distributed in three states in Malaysia: Kedah, Kelantan and Terengganu. The questionnaires were distributed to a total of 750 participants, with each state contributing 250 respondents. Total number of respondents valid for data analysis was however 600.

**Findings** – Based on descriptive and inferential statistics by using the IBM statistical package for the social sciences and structural equation modelling analysis of moment structures, the results show that the main factor influencing women micro-entrepreneurs to use *ar-rahnu* is the service charge.

**Research limitations/implications** – This study only covers three states in Malaysia and is limited to examining the use of *ar-rahnu* by women micro-entrepreneurs in those states.

**Practical implications** – As micro-entrepreneurs often face constraints to obtaining financial access in the formal credit market, *ar-rahnu* provides an alternative mode of obtaining business financing to female micro-entrepreneurs, so they can sustain their operations and even expand their businesses. The significance of such factors like service fee, as revealed in this study, indicates that managers should focus on this element when offering Islamic financial products, especially to women micro-entrepreneurs.

**Originality/value** – The informal credit market theory is frequently used in conventional studies. This paper adds Shari'ah compliance in the context of this theory as a new area to be considered when discussing Islamic financial products.

**Keywords** Shari'ah compliance, *Ar-rahnu*, Informal credit market theory, Women micro-entrepreneurs

**Paper type** Research paper



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## Introduction

Previous studies have shown that the formal credit market (banking in particular) commonly refuses to extend credit facilities to all income groups in the economy because of the high credit risks involved and many other reasons (Ismail and Sanusi, 2005). Consequently, there is a wide disparity between demand and supply of credit. This gap is likely to be filled by the informal credit markets which provide tailor-made financing to match the credit requirements of specific income groups. One of the informal credit markets available is *ar-rahnu* (Islamic pawnbroking) (Abdul Razak, 2011). Even though *ar-rahnu* and informal credit markets are different in terms of their working mechanisms, they still share several aspects of similarity in terms of loan requirements such as collateral, quick process, service charges and others. Hence, it is interesting to review and analyse *ar-rahnu* in the context of the informal credit market because of its increasing role as a financing alternative used by women micro-entrepreneurs as a means to survive in business.

The informal credit market theory has historically been applied to conventional credit analysis. This study attempts to extend the application of the theory to an Islamic context by including Shari'ah (Islamic law) compliance as one of its determinants. Besides, this study also provides possible explanations for what has made the informal credit market theory a powerful tool in explaining *ar-rahnu* as a self-sufficient means of financing for women micro-entrepreneurs.

This study is organised as follows. The second section offers a brief background on the informal credit market theory and *ar-rahnu*. This is followed by a discussion on hypothesis development and literature review. The next section presents the methodology used and thereafter the results and analysis are discussed. A conclusion of the study and some proposed suggestions for future studies are finally provided.

## The informal credit market theory and *ar-rahnu*

The informal credit market theory emanates from the proposition made by McKinnon and Shaw (1973) that total savings in the economy can be optimised provided that interest rates are freed of administrative costs and that excessively stringent collateral requirements are eased. However, the general equilibrium model developed by them does not integrate the mediating effects of financial policies in repressed economies. Thus, to complement their view, an alternative perspective on developing countries' financial markets is provided by the neo-structuralist school.

The neo-structuralist school has a generally similar view to that of McKinnon and Shaw. Both identify the importance of the banking system as the key component of the formal financial sector. Both also emphasise the role of working capital in determining the supply side response of the economy to changes in monetary policy instruments. A key divergence between the views of McKinnon–Shaw and the neo-structuralist school lies in the treatment of informal credit markets. McKinnon and Shaw acknowledged the existence and importance of the informal credit market in their analysis, but it is perceived as inefficient, limited in scope, and not central to the transmission of shocks from the financial to the real sector. In contrast, the neo-structuralist school reserves a prominent place for informal credit markets in its model. This is because of the two important roles played by the informal credit market. First, in the commodity market, the informal credit market plays a role in determining the marginal cost of funds relevant for private spending and saving decisions. Second, the informal credit market represents the alternative modes of financial intermediation available to private savers. This means that the neo-structuralist framework is more comprehensive as compared to the McKinnon–Shaw theory.

Important neo-structuralist studies include those by Van Wijnbergen (1983); Taylor (1983); Buffie (1984); Koshaka (1984) and Liang (1988). The neo-structuralist framework was largely developed to examine the impact of liberalisation policies and some stabilisation measures on economic activities when informal credit markets were incorporated into the economic model. Most neo-structuralists view the informal credit market theory as being rather restrictive. Therefore, neo-structuralists refer to the informal credit market as a curb market. The latter is a market where local farmers sell their goods on the streets. However, this conception is not rational as the bulk of evidence shows that informal credit markets are very different from the competitive, flexibly priced curb market. The informal credit market is said to be usually fragmented, monopolistic and inclined to be characterised by sluggish prices (Srivastava, 1992).

The informal credit market plays a decisive role in channelling credit to small and poor borrowers in both urban and rural areas. Chua and Lianto (1996) affirmed that convenient location, availability of credit at any time and the flexible term structure are the merits of the informal credit market. In addition, the informal credit market does not require complicated procedures and, interestingly, the decision whether to accept or reject applications is immediately known by customers after a short processing time. This was supported by Bhatt (1986); Bouman (1989) and Ghate (1992), who mentioned that informal credit markets respond quickly or remarkably well to short-term financing services at relatively lower cost. These valuable services were not adequately met by formal financial institutions (Timberg and Aiyar, 1984).

The strength of the informal credit market is because of its ability to provide working capital to all business sizes (Abdul Razak, 2011). The informal credit market is frequently related to the non-bank lending rate, which is typically not fixed by the government or other authorities. The interest rates of this informal credit market are determined by market forces of demand and supply (McKinnon and Shaw, 1973). The existence of the informal credit market was recognised by McKinnon and Shaw (1973) who asserted that capital markets in less developed countries (LDCs) are imperfect and fragmented in the sense that there exists discrepancy among rates of return on capital and financial assets. However, in this context, formal credit markets such as banking do not serve as efficient financial intermediaries. This is because of the administratively imposed usury on loans and the strict collateral requirements that generally complicate the loan process.

According to Chan and Owyong (2007), the informal credit market serves the financial needs of the community directly through simplified application procedures, rapid extension of credit, focus on the local market and addressing the needs of poor clients. As stated by Plateau (1994), the informal credit market theory also stresses the issues of efficiency and resource mobilisation, which can be used for modernisation and investment purpose. From the perspective of *ar-rahmu*, it also attempts to attract customers by offering speedy and efficient transactions. It enables a customer to have cash within minutes without having to fill out numerous application forms and enduring a long waiting period required for the approval of bank loans (Chan and Owyong, 2007).

Similar to most informal credit market instruments, *ar-rahmu* also requires collateral for a loan to be disbursed. The collateral is used to minimise loan defaults. In the context of *ar-rahmu*, an asset is pledged as collateral to secure the loan. *Ar-rahmu* institutions normally accept gold or gold jewellery as collateral, mainly because gold has a sufficiently large secondary market and thus has a stable value. These factors can all be pooled into one group reflecting the acceptance factors for use of *ar-rahmu*. Sharing similar characteristics will help ease the interaction between *ar-rahmu* and informal credit markets.

Credit is potentially a prime weapon against rural and urban poverty (Rahman, 1992; Nair, 2001). There is a linear relationship between credit and economic welfare. *Ar-rahnu* has been described as fairly akin to the informal credit market, as both are least supervised and regulated, and both of these non-bank institutions service the financial requirements of small borrowers within the lowest income group (Chua and Lianto, 1996). Therefore, it is argued that the informal credit market needs to be supported and nurtured for its efficiency and its sustaining economic development (Nair, 2001).

*Ar-rahnu* as a financing mechanism has three stages: the lending process, redeeming process and auctioning process. During the lending process, customers approach the institution, offering to place their gold jewellery under the contract of *rahn* (pledge). The institution offering *ar-rahnu* gives loans to customers based on the *qard* (loan) contract. The maximum loan amount offered to customers is about 70 per cent of the gold value. The pledged gold, known as the *marhūn*, is kept by the *ar-rahnu* institution under the principle of *wadī'ah yad ḍamānah* (guaranteed deposit for safekeeping). At this stage, the customers need to pay for service charges based on the *ujrah* (fee) principle. The service charges are paid by customers during the settlement of the loan. Usually, the service charges imposed by the *ar-rahnu* institution are lower than the 2 per cent imposed by conventional pawnshops.

### Hypothesis development

Based on the literature review, there are four key factors that influence the access to credit through the informal credit markets. The variables are customer satisfaction, collateral, locality, and service charges. Another variable is added to this conceptual framework in the form of Sharī'ah compliance. This variable is included in this framework to accommodate the Islamic perspective. Since *ar-rahnu* is a type of Islamic microfinance product available in the financial market, it is deemed important to address the Sharī'ah compliance aspect.

#### *Sharī'ah compliance and the usage of ar-rahnu*

*Ar-rahnu* services use the concepts of *wadī'ah yad ḍamānah* (guaranteed deposit for safekeeping), *qard ḥaṣan* (beneficial loan) and *ujrah* (fees) in their transactions, indirectly eliminating the elements of *ribā* (interest) and *gharar* (uncertainty) (Ismail and Sanusi, 2005; Amin *et al.*, 2007; Sharif *et al.*, 2013). Failure to comply with the Sharī'ah principles will result in failure to achieve the objectives of *ar-rahnu*, notably that of being Sharī'ah compliant.

Amin (2011) found that the most important factors influencing women's use of *ar-rahnu* in eastern Malaysia were Sharī'ah compliance followed by transaction costs of *ar-rahnu*. Hamid *et al.* (2014) also asserted that Sharī'ah compliance was the key criteria that all customers emphasised when they chose *ar-rahnu* services instead of other factors such as locality, service charges, collateral, advertisement and social factors. These studies found that Sharī'ah compliance was among the primary motivations for customers to deal with *ar-rahnu* institutions. Based on the presented scenario, Sharī'ah compliance is expected to positively influence the usage of *ar-rahnu* financing. Accordingly, one of the hypotheses of this study is as follows:

H1. Sharī'ah compliance has a significant influence on the use of *ar-rahnu*.

#### *Customer satisfaction and the usage of ar-rahnu*

The importance of customer satisfaction has often been highlighted by many researchers as a factor contributing to the greater acceptance of *ar-rahnu*. Lao (2005) suggested that *ar-rahnu* institutions have to offer a quick and convenient service to gain acceptance by

customers. Similarly, [Johari et al. \(2007\)](#) found that customer satisfaction through quick and convenient services is an important acceptance factor that convinces customers to deal with *ar-rahnu* instead of other moneylending institutions. Maintaining customers' records, keeping data confidentiality and treating customers fairly regardless of their religion, ethnicity or race were also significant in building customer satisfaction. Other studies by [Amin et al. \(2007\)](#); [Amin \(2011\)](#); [Abdul Khir et al. \(2013\)](#); [Nadiah \(2014\)](#) and [Hamid et al. \(2014\)](#) have provided empirical support for the causal link between customer satisfaction and the usage of *ar-rahnu*.

In studies undertaken by [Abdul Syukor and Sabri \(2013\)](#) and [Wulandari and Kassim \(2015\)](#), responsiveness was used to measure customer satisfaction. It was highlighted that responsiveness had a significantly positive impact on customer satisfaction when using *ar-rahnu*. This finding was supported by [Muhammad Awan et al. \(2011\)](#); [Fararah and Al-Swidi \(2013\)](#) and [Ibarra et al. \(2014\)](#). In short, the better the service quality offered by the institutions, the higher the tendency would be for customers to want to deal with them. [Cronin and Taylor \(1992\)](#) mentioned that service quality was a vital antecedent of customer satisfaction. [Othman and Owen \(2001\)](#) also stated that there was a strong link between service quality and customer satisfaction.

Therefore, on the basis of these prior studies, this research proposes customer satisfaction as a factor that will positively influence the usage of *ar-rahnu* financing. The second hypothesis is thus formulated as follows:

*H2. Customer satisfaction has a significant influence on the use of ar-rahnu.*

#### *Collateral and the usage of ar-rahnu*

Collateral or a pledged item is a valuable asset that a borrower (*ar-rahin*) transfers to the possession of a lender (*al-marhūn bih*) for the purpose of a loan. [Amin et al. \(2007\)](#) and [Sulaiman et al. \(2014\)](#) defined a valuable asset as all types of gold products such as gold bars, gold coins, gold with stones, gold jewellery and many other types of gold items. According to [Ismail and Ahmad \(1997\)](#) and [Sanusi and Johari \(2006\)](#), *ar-rahnu* institutions routinely accept valuable assets such as gold and gold jewellery only. This is usually adopted to avoid unnecessary risks. This study focuses on women, and gold is one of a woman's precious possessions as compared to other valuable items. Thus, gold can prove to be a woman's saviour at a stage when her business critically needs financing ([Amin, 2011](#)).

A large amount of gold being pawned signifies a potentially larger amount of cash being disbursed by institutions offering *ar-rahnu*. There are a number of studies showing a significant relationship between the collateral (gold) and the use of *ar-rahnu* services. These include the studies conducted by [Amin et al. \(2007\)](#); [Yunta \(2007\)](#); [Ahmad et al. \(2012\)](#) and [Sharif et al. \(2013\)](#). The third hypothesis in this study, therefore, relates to the relationship between collateral and the use of *ar-rahnu* services:

*H3. Collateral has a significant influence on the use of ar-rahnu.*

#### *Locality and the usage of ar-rahnu*

The closer the institution offering *ar-rahnu* services is to its potential customers, the higher the tendency will be for those customers to use *ar-rahnu* ([Hamid et al., 2014](#)). [Johari et al. \(2007\)](#) showed that potential customers were most likely to prefer pawnshops near their houses as they can save money on transportation and waiting cost.

[Amin et al. \(2007\)](#) proposed that *ar-rahnu* institutions which operate in different locations must highlight this accessibility advantage to potential customers. Customers may prefer to

pawn their jewellery with the nearest *ar-rahmu* institution for the sake of convenience and, to a certain extent, lower transportation costs. On the basis of these findings, it is important to have *ar-rahmu* services near to customers, as this enhances the tendency of customers to use *ar-rahmu* financing. The fourth hypothesis is accordingly:

*H4. Locality has a significant influence on the use of ar-rahmu.*

#### *Service charges and the usage of ar-rahmu*

In the current context of business transactions, *ar-rahmu* providers would naturally incur costs to keep pledged items safe. Thus, *ar-rahmu* providers have to impose certain service charges at a certain rate. Conceptually, the service charges imposed by *ar-rahmu* institutions are treated as *hibah* (gift) on the part of the customers of the institutions (Ismail and Sanusi, 2005). The gift is given as a symbol of gratitude, for *ar-rahmu* providers play the role of protecting customers' pledged items. For *ar-rahmu* providers, these charges are meant to cover all the costs incurred in safeguarding the pledged items, including insurance and security (Hamid *et al.*, 2014). However, Mohd Hussin *et al.* (2016) noted that these costs might be burdensome to customers and indirectly contribute to customers default in fulfilling payment.

The issue of lower service charges imposed by *ar-rahmu* providers was also supported by Ismail and Ahmad (1997); Hisham Sabri *et al.* (2013) and Suhana *et al.* (2016). These studies mentioned that *ar-rahmu* provides a cheaper way to obtain financing and is free from interest. This study also found that a service charge imposed under *ar-rahmu* is relatively cheaper than the conventional pawnbroking system. This would mean that the cost of borrowing cash in the case of *ar-rahmu* is lower than in a conventional pawnshop. Other studies by Ismail and Ahmad (1997); Amin (2011); Cheong and Sinnakkannu (2012) and Mohd Hussin *et al.* (2016) found *ar-rahmu* providers to charge a relatively lower transaction fee as compared to conventional pawnshops. Conventional pawnbroking imposes high rates of interest (Appannan and Doris, 2010; Sulaiman *et al.*, 2014). Thus, the service charges imposed by *ar-rahmu* providers are cheaper than conventional pawnshops. This encourages customers to use *ar-rahmu* services rather than conventional pawnshops. The fifth hypothesis thus relates to service charges:

*H5. Service charges have a significant influence on the use of ar-rahmu.*

#### **Methodology**

The primary data collected for the purpose of this study were obtained from the method of purposive sampling by using self-administered questionnaires. Purposive sampling is a sampling method that is selected based on the researcher's knowledge of the population and what type of sample would best suit his or her goals (Wolfer, 2007). This is a useful technique if the population of interest is one that can be easily identified but not easily listed (Wolfer, 2007). As the focal point of this research is to conduct a study on women micro-entrepreneurs who rely on *ar-rahmu* for capital, the most appropriate sampling was purposive sampling. The researcher obtained information on women micro-entrepreneurs who used *ar-rahmu* from their friends in the same market and selected these women micro-entrepreneurs as a sample to be included in this study.

The study was conducted in three states in Malaysia: Kelantan, Terengganu and Kedah. According to the Department of Statistics, Malaysia (2011), these three states have majority women micro-entrepreneurs and have higher poverty indices compared to other states in Malaysia. The questionnaires were distributed to a total of 750 participants, with each state

contributing 250 respondents. Out of the 750 questionnaires distributed, 629 surveys were returned. In total, 29 surveys had more than 25 per cent of the items unanswered. This resulted in an effective sample of 600 usable completed questionnaires for the purpose of data analysis.

The analysis is based on descriptive and inferential statistics by using IBM statistical package for the social sciences and structural equation modelling (SEM) analysis of moment structures. Analysis of moment structures is used because of its capabilities for handling multiple group analysis, non-normal variables and missing data.

## Results and findings

The questionnaire method was used to collect the demographic and descriptive characteristics of the respondents. Important factors that were collected included marital status, ethnicity, age, education level and years of business experience. The nominal scale was used to measure demographic variables for each question.

Based on [Table I](#), most of the respondents (81.2 per cent) were married compared to 18.3 per cent of respondents who were still single. About 0.5 per cent of the respondents were widows. [Table I](#) also shows that the respondents were dominated by Malays (99 per cent), followed by Indians (0.7 per cent) and Chinese (0.3 per cent). This finding aligns with that of [Hamid et al. \(2014\)](#), who found that 98.1 per cent of respondents were Malays, followed by Chinese (1.9 per cent). The survey findings further reveal that a significant majority of respondents (31.0 per cent) were from the 31-40 years age group, followed by 41-50 years (26.5 per cent), 21-30 years (22.0 per cent), 51-60 years (12.2 per cent) and 61-70 years (7.0 per cent), and the minority was from 71 years and above (with only 1.3 per cent).

The results also show that most respondents had secondary level education (66.2 per cent) compared to those holding certificates or diplomas (14.7 per cent) and primary school certificates (8.5 per cent). Interestingly, some respondents (8.7 per cent) were without formal education. In terms of the type of industry, most respondents were from the textiles industry (50.7 per cent), followed by the food industry (36.3 per cent), others (8.7 per cent) and agriculture (4.3 per cent). Besides, the demographic profile also shows that 66.3 per cent of respondents were mostly still new in entrepreneurship with only 1-10 years of experience in business. The second largest category was 25.3 per cent with 11-20 years of business experience. Among others, *ar-rahnu* services offered by Bank Islam (37.2 per cent) were the most favoured by women micro-entrepreneurs, followed by *ar-rahnu* by Bank Rakyat (26.7 per cent) and Pos Malaysia Berhad (14 per cent).

### *Exploratory factor analysis*

A factor analysis with varimax rotation was carried out to validate whether the respondents perceived the six constructs of Shari'ah compliance (SC), customer satisfaction (CS), collateral (CL), service charges (SCs), locality (LC) and usage (USAGE) to be distinct. The results show a seven-factor solution and the total variance explained is 62.66 per cent of the total variance.

The KMO measure of sampling adequacy is 0.898, indicating sufficient inter-correlations. Besides, the *p*-value for the Bartlett's test in this study is 0.000 for all variables. This gives a signal that variables are perfectly significant at  $p < 0.05$ . [Table II](#) shows the results of the exploratory factor analysis (EFA). Communalities (represented by C in [Table II](#)) indicate the degree to which the factors explain the variance of the variables. Communality of a variable represents the proportion of the variance in that variable that can be accounted for by all extracted factors. Low values of communality of less than 0.3 could indicate that the item does not fit well with the other items in its component. Based on [Table II](#), all items have

Respondent demographics	Details	Frequency [%]
Marital status	Married	487 [81.2]
	Single	110 [18.3]
	Others (Widows)	3 [0.5]
Race	Malay	594 [99.0]
	Chinese	2 [0.3]
	Indian	4 [0.7]
Age	21-30 years	132 [22.0]
	31-40 years	186 [31.0]
	41-50 years	159 [26.5]
	51-60 years	73 [12.2]
	61-70 years	42 [7.0]
	71 years and above	8 [1.3]
Education level	No formal education	52 [8.7]
	Primary school	51 [8.5]
	Secondary school	397 [66.2]
	Certificates/diploma	88 [14.7]
	Bachelor's degree	12 [2.0]
Location of business ( <i>N</i> = 600)	Kelantan	200 [33.3]
	Terengganu	200 [33.3]
	Kedah	200 [33.3]
Type of industry	Agriculture	26 [4.3]
	Food	218 [36.3]
	Textiles	304 [50.7]
	Others	52 [8.7]
	Business experience	1-10 years
	11-20 years	152 [25.3]
	21-30 years	35 [5.8]
	31-40 years	11 [1.8]
	41 years and above	4 [0.7]
<i>Ar-rahnu</i> visited	Bank Islam	223 [37.2]
	Bank Rakyat	160 [26.7]
	AgroBank	46 [7.7]
	YaPEIM	59 [9.8]
	Permodalan Kelantan Berhad	12 [2.0]
	Muassasah Gadaian Islam Terengganu	16 [2.7]
	Pos Malaysia Berhad	84 [14.0]

**Table I.**  
Profile of  
respondents

communality values above 0.5. This means that all items have 50 per cent explained a variable's variance. To acquire this variance, a few items need to be deleted. These items are CL1-CL5 (collateral), LC5 (locality), USAGE3 (usage) and USAGE6 (usage). These items are deleted because of having the lowest values for communality, redundant factor loading and also low loading values, below 0.5. These items were thus excluded in [Table II](#).

#### *Structural equation modelling*

Once all constructs in the measurement model (stage one) are validated and satisfactory fit is achieved ([Anderson and Gerbing, 1988](#)), a structural model can then be tested and presented as a second and main stage of the analysis. According to [Byrne et al. \(1989\)](#), the structural model aims to specify which latent constructs directly or indirectly influence the value of the other latent constructs in the model. Therefore, to test the underlying, SEM is used. Goodness-of-fit indices are used to assess if the hypothesised structural model fits the

	SC	CS	SCs	LC	USAGE	C
<i>Ar-rahnu</i> features comply with the principles of Shari'ah [SC1]	0.769					0.756
The process at <i>ar-rahnu</i> is more transparent (especially in valuing the collateral) [SC2]	0.821					0.778
<i>Ar-rahnu</i> conforms to my faith of abstaining from paying the increment in borrowing [SC3]	0.716					0.572
<i>Ar-rahnu</i> conforms to my faith of abstaining from uncertainty [SC4]	0.755					0.640
The operations of <i>ar-rahnu</i> are based on Islamic law principles [SC5]	0.702					0.609
<i>Ar-rahnu</i> always has a quick response to customers' demands [CS1]		0.602				0.635
<i>Ar-rahnu</i> ensures the security and confidentiality of transactions [CS2]		0.614				0.558
<i>Ar-rahnu</i> gives a fair treatment to all religions and races [CS3]		0.678				0.612
<i>Ar-rahnu</i> always issues a receipt after each transaction [CS4]		0.707				0.632
<i>Ar-rahnu</i> staff are knowledgeable and competent [CS5]		0.706				0.581
<i>Ar-rahnu</i> officers are trying to minimise the errors of work [CS6]		0.683				0.569
<i>Ar-rahnu</i> officers always fulfil the promise of their services in a timely manner [CS7]		0.608				0.522
<i>Ar-rahnu</i> sets fair service charges for the lower income earner [SCs1]			0.693			0.582
<i>Ar-rahnu</i> imposes the lowest service charges as compared to other money lending institutions [SCs2]			0.832			0.715
Service charges are based on the value of gold [SCs3]			0.832			0.720
The higher the loan amount, the higher the service charges [SCs4]			0.724			0.586
<i>Ar-rahnu</i> sets competitive service charges to customers [SCs5]			0.766			0.602
<i>Ar-rahnu</i> practices <i>ibra'</i> (discount) for earlier redemption [SCs6]			0.653			0.578
<i>Ar-rahnu</i> is located near my house or my workplace [LC1]				0.674		0.587
I always find <i>ar-rahnu</i> near to public transportation centres [LC2]				0.649		0.547
I often travel to the city to deal with <i>ar-rahnu</i> [LC3]				0.704		0.616
<i>Ar-rahnu</i> is located near shopping complexes and business centres [LC4]				0.669		0.615
I always use <i>ar-rahnu</i> for rolling the business' capital [USAGE1]					0.697	0.565
I frequently use <i>ar-rahnu</i> to finance my start-up business [USAGE2]					0.887	0.850
I regularly use <i>ar-rahnu</i> to improve my capital in doing business [USAGE4]					0.811	0.755
I often use <i>ar-rahnu</i> to buy my business' fixed assets [USAGE5]					0.637	0.510
% of Variance (62.664)	13.855	14.864	14.188	10.496	8.041	
Keiser–Meyer–Olkin (KMO) measure					0.898	
Bartlett's test					0.000	

**Notes:** Kaiser–Meyer–Olkin (KMO) test is a measure of sampling adequacy while Bartlett's test is to test if the samples are from populations with equal variances. C stands for communalities

**Table II.**  
EFA

data. The fitness of the model did not just rely on the test of the absolute model fit (the chi-square statistics) because of its rigidity and sensitive nature of large sample size. The fit indices were inclusive of goodness-of-fit (GFI), comparative fit index (CFI) and root mean square error of approximation (RMSEA) to assess the magnitude of residuals of the structural model. If the goodness-of-fit indices did not fit, then the requirement is to rectify the model until acceptable statistical indices are achieved (Tabachnick and Fidell, 2007). The results for the hypothesised structural model are shown in Figure 1.

Based on the hypothesised model, the results for normed chi-square statistics was 4.554 ( $\chi^2 = 1299.465$ ,  $df = 286$ ). Both CFI and GFI scored 0.90, which supported the model. Besides, the RMSEA confirms that the structural model has adequately fitted the data with value of 0.077, within the required value of less than 0.10. Table III summarises the results of the hypotheses. The table shows that ‘service charge’, with a factor loading value of 0.27, is an important factor in the usage of *ar-rahnu*. This is followed by “locality”, with a factor loading value of 0.24, which is indicative that easy access to financing is another important factor affecting the use of *ar-rahnu* services by women entrepreneurs.

**Conclusion and way forward**

*Ar-rahnu* is one of the modes of informal credit that can cater for the unique financing requirements of women micro-entrepreneurs by providing instant cash as compared to

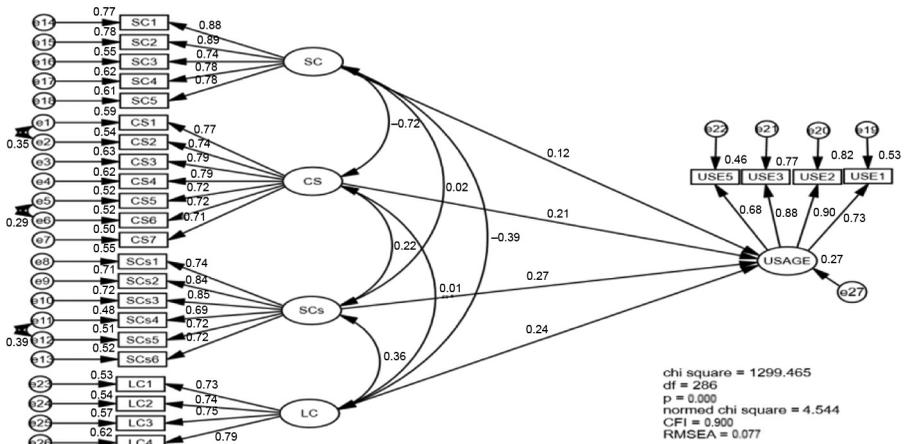


Figure 1.  
SEM

Source: Authors

Table III.  
Results of the  
hypotheses

Hypothesis	Relationship	Coefficient	Effect
H1	Shari'ah compliance has a significant influence on the use of <i>ar-rahnu</i>	0.12*	Supported
H2	Customer satisfaction has a significant influence on the use of <i>ar-rahnu</i>	0.21*	Supported
H3	Collateral has a significant influence on the use of <i>ar-rahnu</i>	nil	Rejected
H4	Locality has a significant influence on the use of <i>ar-rahnu</i>	0.24*	Supported
H5	Service charges have a significant influence on the use of <i>ar-rahnu</i>	0.27*	Supported

Note: \*Significant at  $p < 0.05$  level

the financing offered by formal institutions. This study systematically arranged factors that influence women micro-entrepreneurs to use *ar-rahnu* as a medium of financing, a method which has not been highlighted in previous studies. The application of *ar-rahnu* in the informal credit market theory has highlighted the important factors influencing women micro-entrepreneurs to make use of *ar-rahnu* services. A few factors have been addressed, namely, Shari'ah compliance, customer satisfaction, collateral, locality and service charges.

Note that collateral has been excluded during the EFA because of the lowest values for communality, redundant factor loading and low loading values, which is below 0.5. Service charges with factor loading value 0.27 have shown a strong relationship in the usage of *ar-rahnu*. This finding is in agreement with the finding of Abdul Razak (2011) and Mohd Hussin *et al.* (2016), who found that low service charges could actually enhance the rate of using *ar-rahnu*. In contrast, in this study, Shari'ah compliance was found to represent the lowest factor loading (0.12) value among women micro-entrepreneurs in their choice of *ar-rahnu*. This might be because of the fact that the amount they get from pawning is considered more important to the women entrepreneurs than bothering whether *ar-rahnu* is Shari'ah-compliant. The main intention when they pledge assets is to get cash instantly for the purpose of financing their business. The women entrepreneurs appear to be more concerned with practical issues such as low service charges, closeness of the *ar-rahnu* institution which facilitates access to financing and customer satisfaction. The study revealed that the women entrepreneurs were relatively unconcerned with other factors such as product structuring or Shari'ah compliance of the facility.

Research on *ar-rahnu* in Malaysia is still scarce; thus, there is a need for future research to be conducted on this topic. Future studies need to explore more on *ar-rahnu* operations, specifically on the issue of different service charges and margin values being charged to customers by different *ar-rahnu* institutions. They should also explore if it is possible to standardise the service charges across all *ar-rahnu* institutions. Besides, future studies also need to review the impact of *ar-rahnu* on different focus groups, covering, for instance, the western region (Selangor and Kuala Lumpur) which is populated with higher income groups (top 20 per cent, middle 40 per cent) of Malaysia.

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