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BizFame 2024: 3rd International Conference on Business Finance Management & Economics
Suan Sunandha Rajabhat University, Bangkok, Thailand, 24 & 25 October 2024

Organised by: Universiti Teknologi MARA, Kedah, Malaysia

Factors Influencing Mortgage Redemption Performance for Microfinancing Ar Rahnu Among B40 Entrepreneurs

Mohammed 'Izzuddin Ismail*, Nurzafreena Abdul Aziz,
Tengku Maaidah A Razak, Mohd Faiz Mohamed Yusof
**Corresponding Author*

Academy of Contemporary Islamic Studies (ACIS),
Universiti Teknologi MARA, Shah Alam, Malaysia

izzuddinismail@uitm.edu.my, inazafreen@gmail.com, tengkumaaidah@uitm.edu.my, faizyusof@uitm.edu.my
Tel: 012-2552442

Abstract
Ar Rahnu has become an essential financial service in Malaysia, especially for B40 Entrepreneurs. However, the failure rate of mortgage redemption among B40 Entrepreneurs shows worrying figures. This research will identify the factors that affect mortgage redemption, such as business factors, borrower's attitudes towards their loans, other debt burden, and the amount of loans received. The theory of KAP is used as the focal theory. The results of this research will help Ar Rahnu's institutions and B40 entrepreneurs overcome mortgage redemption failures.

Keywords: Ar Rahnu; B40 Entrepreneurs; KAP Theory; Factors influencing mortgage redemption.

DOI: https://doi.org/10.21834/e-bpj.v10iSI28.6953

1.0 Introduction

In 1992, the Muassasah Gadaian Islam Terengganu (MGIT) and Permodalan Kelantan Berhad (PKB) initiated the Islamic pawnshop, known as the Ar-Rahnu scheme. More institutions are involved in the scheme (Rahman & Kassim, 2017). Nonetheless, among the first government organizations to organize the operation of the Islamic pawnshop system in Malaysia was Yayasan Pembangunan Ekonomi Islam Malaysia (YaPEIM) (Yusuff et al., 2015).

According to a study conducted after implementing the legislation over 30 years ago, Malaysia had more Islamic pawnshops than traditional pawnshops (Saiman & Zainuddin, 2022). Periodically, there was an increase in both the number of clients and loans accepted (Hussin et al., 2016).

According to YaPEIM's statement in 2019, the value of unclaimed pledged items was as much as 388kg, valued at RM62.8 million from 2012-2014. This shows the importance of financial flow to Ar Rahnu in ensuring the continuation of microfinancing. Since most Ar Rahnu microfinancing program participants are micro-entrepreneurs, especially B40 entrepreneurs, this research was conducted to see the performance factors of mortgage redemption among B40 entrepreneurs.

This research has the following objectives:

Research objective 1: To examine the effect of business factors on mortgage redemption performance.

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Research objective 2: To examine the effect of borrower's attitudes towards their loans on mortgage redemption performance.
Research objective 3: To examine the effect of other debt burdens on mortgage redemption performance.
Research objective 4: To examine the effect of the loan amount received on mortgage redemption performance.

2.0 Literature Review

Mortgage redemption performance refers to the borrower's behaviour in redeeming the mortgage from the pawn service provider in the specific period and amount stated in the agreement. Mortgage redemption performance is an essential component of the pawning sector. Borrowers who do not pay their loans on time continuously may experience default. Default is represented by the Non-Performing Loan (Schulte & Winkler, 2019). Credit risk is represented by the Non-Performing Loan index, where a larger Non-Performing Loan indicates a higher potential risk assumed by the financial institution. Credit risk impacts financial stability (Isnurhadi et al., 2021). Moreover, defaults might harm lending institutions by raising the cost of loan collection, restricting credit availability, and impeding the financial industry's growth (Dangisso & Deyganto, 2020). Figure 1 shows the conceptual framework of this research.

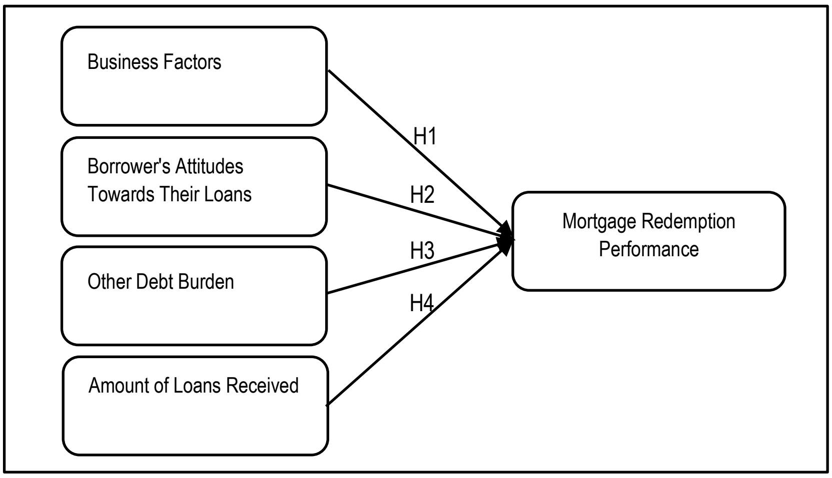

Fig. 1: Conceptual framework
(Source: Authors' Work)

2.1 Mortgage Redemption Performance
Business factors
Business factors can significantly influence a company's ability to repay loans and mortgage redemption (Angaine & Waari, 2014). Cash flow, profitability, and overall financial stability are all important for repaying loans and mortgage redemption.

Revenue stability and growth provide a reliable source of income to cover loan repayments and mortgage redemption. Even during economic downturns, businesses with consistent sales are better positioned to meet their debt obligations. Declining or highly volatile revenue makes it difficult to predict cash flow and can lead to missed payments. Seasonal businesses may struggle with repayment during off-peak periods.

Higher profit margins mean a business retains more revenue as profit, increasing its capacity to cover fixed costs, including loan repayments and mortgage redemption. Efficient cost management and pricing strategies can enhance margins. Low or shrinking profit margins reduce the cushion available to absorb debt payments. If a company's expenses increase with a corresponding rise in revenue, profitability may improve, making repayment more challenging.

Effective cash flow management ensures the business has sufficient liquidity to meet short-term obligations, including loan payments and mortgage redemption. Proper forecasting, timely collection of receivables, and payables control are essential practices. Meanwhile, poor cash flow management can lead to liquidity shortages, even if the business is profitable on paper. Issues such as delayed customer payments, excessive inventory, or poor expense control can create cash flow problems that hinder timely loan repayment and mortgage redemption.

Businesses that maintain stable revenues, manage their costs effectively, and adapt to market changes are better positioned to meet their loan obligations. Conversely, factors like declining revenues, poor cash flow management, high leverage, and inefficient operations can strain a company's financial resources, increasing the likelihood of loan default. Understanding and managing these business factors is crucial for businesses and lenders to assess the risk associated with financing and ensure successful loan repayment and mortgage redemption. This research will investigate the effect of business factors on mortgage redemption performance. The researchers formulate a hypothesis regarding the relationship between business factors and mortgage redemption performance as follows:

H_1 There is a positive and significant direct relationship between business factors and mortgage redemption performance.

Borrower's attitude toward their loans.

A borrower's attitude toward their loans plays a significant role in their approach to repayment and can directly impact their ability to meet loan obligations and mortgage redemption (Goel & Rastogi, 2021).

Borrowers who view their financing as a serious obligation and are committed to fulfilling their repayment terms are more likely to make timely payments. A strong sense of responsibility drives them to prioritize loan repayment and mortgage redemption, even when facing financial challenges. Meanwhile, a borrower who needs more commitment or views the loan as a priority may delay or miss payments, leading to penalties, increased interest, and potential default. They might be more likely to misuse funds or need to set aside money for repayment and mortgage redemption.

When the borrowers trust their lender and believe that the lender has their best interests in mind, they are more likely to engage in open communication about repayment challenges and seek help if needed (Ahmad, 2023). This trust can lead to proactive management of the loan, such as requesting payment restructuring before problems get out of hand. A lack of trust in the financier can lead to a negative attitude toward the loan. Borrowers might avoid communicating about difficulties, leading to missed payments and defaults. Additionally, if they believe the lender is unfair or exploitative, they can feel less obligated to repay the loan and redeem the mortgage.

Borrowers who see their loan as an investment in their future, for example, starting a business, education, or home ownership, are more likely to be diligent in repaying it, as they associate the loan with achieving personal or professional goals (Hwang et al., 2019). When a borrower views the loan as "free money" or does not fully understand its purpose or impact, they may misuse the funds, leading to difficulty in repayment and mortgage redemption. This attitude can result in reckless spending, misallocation of resources, and eventual default.

A borrower's attitude towards their loan is important in determining their repayment behaviour. Positive attitudes such as responsibility, trust in the lender, a strategic view of debt, and a commitment to financial planning result in timely and consistent repayment of loans and mortgage redemption. Negative attitudes, on the other hand, such as indifference, distrust, fear, or poor financial management, can lead to repayment difficulties, increased debt burdens, and potential default. Lenders and financial educators can help shape positive attitudes by providing clear communication, education, and support, improving loan repayment and mortgage redemption outcomes. This research will investigate the effect of borrower's attitude toward their loans on mortgage redemption performance. The researchers formulate a hypothesis regarding the relationship between borrower's attitude toward their loans and mortgage redemption performance as follows:

H_2 There is a positive and significant direct relationship between borrowers' attitudes toward their loans and mortgage redemption performance.

Other debt burdens

Other debt burdens can significantly affect borrowers' ability to repay loans and mortgages (Stephen, 2020). When borrowers have multiple debts, their financial obligations also increase, which can strain their cash flow and reduce their capacity to manage additional loan repayments and mortgage redemption.

The debt-to-income (DTI) ratio measures the percentage of a borrower's income that goes toward servicing debt. A higher DTI ratio means a larger portion of the borrower's income is already committed to existing debt payments, leaving less room for new loan obligations. When a borrower has a high DTI ratio, taking on additional debt can lead to overextension, making it challenging to keep up with all payments. This situation can result in missed or late payments, penalties, and potential default.

Other debt obligations consume cash flow, leaving less liquidity to cover additional loan payments. The more debt borrowers have, the more their cash flow is stretched across multiple obligations (Loibl et al., 2020). Insufficient cash flow can lead to an inability to meet payment schedules on new or existing loans. Cash flow constraints are particularly problematic during periods of lower income or unexpected expenses.

Managing multiple debts can lead to stress, anxiety, and financial strain, which can affect a borrower's ability to focus on making timely payments (Ryu & Fan, 2023). Stress may also lead to poor financial decision-making, such as ignoring payment obligations, engaging in risky financial behaviours, or delaying communication with lenders when problems arise, which can result in missed payments or default.

Other debt burdens can significantly affect a borrower's capacity to repay additional loans by straining cash flow, increasing financial obligations, and making debt management more difficult. A high debt load can lead to a vicious cycle of borrowing, reduced financial flexibility, and increased risk of default. Lenders typically assess the borrower's overall debt burden before issuing new loans to gauge their ability to manage additional debt. This research will investigate the effect of other debt burdens on mortgage redemption performance. The researchers formulate a hypothesis regarding the relationship between other debt burdens and mortgage redemption performance as follows:

H_3 There is a positive and significant direct relationship between other debt burdens and mortgage redemption performance.

Amount loan received

The loan amount received can significantly impact a borrower's ability to repay the loan and mortgage redemption (Trautmann & Vlahu, 2013). This situation occurs when the loan amount directly affects the size of the monthly payments, assuming the interest rate and loan term remain constant.

A larger loan amount typically results in higher monthly payments, which can strain the borrower's cash flow and budget. If the borrower’s income does not increase proportionally to cover these higher payments, it may lead to financial stress and increase the risk of missed or late payments. Meanwhile, a smaller loan amount leads to lower monthly payments, which are easier to manage and less likely to cause financial strain, thus reducing the risk of default.

The loan amount can affect the loan term, as larger loans are often spread out over more extended periods to improve the manageability of monthly payments. While extending the loan term may lower monthly instalments, it also increases the total interest paid throughout the loan, potentially making it more expensive overall (Ahmad, 2023). If financial conditions change, borrowers may pay more than anticipated, leading to repayment challenges. A smaller loan might allow for a shorter repayment term, which, although it may require higher monthly instalments, reduces the total interest paid and the duration of the financial commitment.

The total interest paid on a loan is a function of the loan amount and the interest rate. Larger loan amounts accumulate more interest over time, especially with higher interest rates or extended periods. A higher interest burden increases the overall cost of the loan, which can strain the borrower's finances, particularly if interest payments exceed initial expectations. This situation can make the loan harder to repay, especially if the borrower experiences changes in income or unexpected expenses (Atichasari et al., 2023). A smaller loan reduces the total interest, making it easier to manage and repay within the borrower's financial means.

The amount of loan received is a crucial factor in determining a borrower's ability to repay and mortgage redemption. Larger loan amounts generally mean higher monthly instalments, greater interest costs, and increased financial pressure, which can strain the borrower's resources and increase the risk of default. Conversely, smaller loan amounts are easier to manage, reduce financial stress, and provide flexibility, making repayment more achievable. Borrowers should carefully consider their financial situation, future income potential, and overall debt burden when deciding on the loan amount to ensure they can comfortably meet their repayment obligations. This research will investigate the effect of the loan amount received on mortgage redemption performance. The researchers formulate a hypothesis regarding the relationship between the amount of a loan received and mortgage redemption performance as follows:

H_4 There is a positive and significant direct relationship between the amount of a loan received and mortgage redemption performance.

2.2 KAP Theory

The Knowledge, Attitude, and Practice (KAP) Theory is widely applied in fields such as health promotion, education, and change in behaviour (Bano et al., 2013). However, it is also adaptable for application in financing, especially in addressing issues like financial literacy, microfinance, or capital access for underprivileged groups like the B40 group in Malaysia.

KAP Theory can be applied to financing, particularly in promoting financial literacy and better access to finance. Knowledge (K) can be defined as individuals who know about financial services, products, or management. It includes their understanding of savings, credit, investment, insurance, and overall financial planning (Hussain et al., 2018).

Applying knowledge in financing may help many underserved groups, like the B40 segment, with limited financial literacy. They may need to fully understand how financial systems work, what loan products are available, or how to effectively manage personal or business finances. Programs aimed at improving knowledge focus on educating entrepreneurs about different financial instruments, building their understanding of budgeting, investment options, and debt management, and providing educational programs, workshops, or digital literacy courses that cover basic and advanced financial concepts to B40 entrepreneurs or any underbanked group. Knowledge-building ensures that people make informed decisions when accessing financial services.

Attitude (A) can be defined as encompassing people's beliefs, perceptions, and feelings toward financial services or behaviours, such as borrowing, saving, or investing. It is influenced by cultural, social, and economic factors (Ameliawati & Setiyani, 2018).

Applying an attitude in financing by changing their perception towards responsible borrowing or investments can encourage them to engage more with financial services. Many B40 entrepreneurs might have a negative attitude toward formal financial systems due to past bad experiences, such as high interest rates, lack of trust in institutions, and fear of indebtedness. This also encourages a positive attitude toward risk-taking and entrepreneurship and boosts the willingness to seek funding for business ventures. Therefore, positive reinforcement campaigns, testimonials from successful entrepreneurs, and financial counsellors or advisors who build trust with individuals can help shift negative attitudes. Peer support groups and community-based finance cooperatives can also foster a more supportive attitude toward using financial products.

Furthermore, Practice (P) can be explained as the actual behaviour or actions individuals take about financing, including managing savings, accessing credit, and making investments (Rahman et al., 2021).

While the application of practice in financing, people may still not practice good financial habits even when they have financial knowledge and positive attitudes. For instance, they may not save regularly, avoid taking loans for fear of debt, or fail to invest wisely. B40 entrepreneurs may not actively seek loans or engage in financial practices due to practical barriers like access or fear of rejection.

Therefore, financial programs should focus on creating easy and accessible opportunities to apply knowledge. For example, microfinancing schemes can be introduced that offer lower entry barriers and simple loan terms. These FinTech solutions make financial services more accessible and practical for underserved communities and encourage savings through incentivized saving schemes or matching contributions.

Enhancing all three aspects can result in better repayment practices, lower default rates, and a more favourable mortgage redemption among B40 Entrepreneurs.

3.0 Research Design

This research will utilize a quantitative survey method. The research population comprises B40 entrepreneurs in Klang Valey, Malaysia. The researchers meticulously design a set of survey questionnaires to measure all the variables in this research. Existing measures of business factors, borrowers' attitudes towards their loans, another debt burden, and the number of loans received will be adopted or adapted accordingly when designing and constructing the questionnaire for this research. The questionnaire also contains demographic measures, including age, gender, type of business and age of the business. The researcher will send the final draft of the questionnaire to experts, including the academician. Feedback and comments from the experts will be used to improve the questionnaire and obtain content validity. The researchers will use an online survey tool to distribute the questionnaire to the respondents. The questionnaire will ask these B40 entrepreneurs about business factors, borrowers' attitudes towards their loans, another debt burden, and the number of loans received towards mortgage redemption performance.

Furthermore, this research ethics, as the identity of the respondents, will remain anonymous. This research will use the Statistical Package for Social Science (SPSS) to analyze the preliminary data collected and produce a descriptive analysis of the samples, including means, standard deviation and frequencies. This research will employ structural equation modelling to identify the causal interrelationship between all the variables.

4.0 Conclusion and Recommendations

This research has developed a comprehensive conceptual framework examining the factors influencing mortgage redemption performance for microfinancing Ar Rahnu among B40 entrepreneurs. To the author's knowledge, this is the first time such a framework will be tested comprehensively. Previous studies conducted by Shiferaw & Abuye (2019) present the institution's credit term, credit monitoring, collateralized loan and loan supervision descriptively as the causes that affect Micro Financing Institution loan repayment and defaults. In contrast, this research establishes an integrative conceptual model comprising business factors, borrower's attitudes towards their loans, other debt burden, and the amount of loans received. Additionally, this research provides essential lessons on default mortgage redemption by applying the Theory of KAP as the focal theory to examine the relationship between knowledge, attitude and practice. The KAP Theory's application in financing helps create a structured pathway for improving financial behaviours, ensuring that interventions are not just about access but also about the sustainable use of financial tools and services.

The first recommendation is to increase financial literacy among microfinancing participants. Knowledge-based interventions can improve understanding of financial products, reducing the risk of poor financial decisions and mortgage redemption performance. The second recommendation is to apply sustainable financial practices among microfinancing participants. Teaching good financial habits through practical engagement can lead to long-term financial stability for micro-entrepreneurs, especially B40 entrepreneurs, and can avoid unclaimed mortgage redemption in the future.

Acknowledgements

This research is based on a Fundamental Research Grant Scheme (FRGS) awarded by the Ministry of Higher Education Malaysia, Reference Code: FRGS/1/2023/SS02/UITM/02/8. The authors also want to thank the Ministry of Higher Education Malaysia for granting the 600-RMC/FRGS 5/3 (170/2023) grant entitled “Pembentukan Model Penebusan Gadaian (er-Ar Rahnu) Bagi Program Pembiayaan Mikro Ar Rahnu Dalam Kalangan Usahawan B40”.

Paper Contribution to Related Field of Research

The main contribution of this research is the service provider that offers micro-financing of Ar Rahnu from the banking and non-banking sectors in managing the financial policy and practice to avoid defaulters in mortgage redemption among micro-entrepreneurs, especially the group of B40 entrepreneurs. The second contribution of this research is the participation of microfinancing Ar Rahnu. This research may help micro-financing participants, especially B40 entrepreneurs, enhance their performance in mortgage redemption and change perceptions about borrowing, showing that financing can be a tool for growth. Besides that, the contribution of this research is related to agencies providing financial education programs for micro-entrepreneurs. This research explained the factors of mortgage redemption performance among micro-entrepreneurs, especially for B40 entrepreneurs, which encourages good financial habits and ensures that knowledge and attitude translate into sustainable financial behaviours.

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