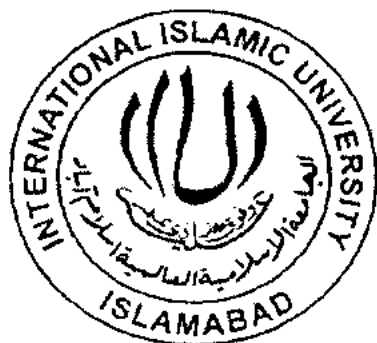


**SHARIAH APPRAISAL OF ISLAMIC MICROFINANCE
INSTITUTIONS IN INDONESIA: An Analytical and Critical Study of
Bait al-Mal wa at-Tamwil**

Submitted in partial fulfillment of the
requirements for the degree of MS (Islamic Commercial Law)



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Final Approval

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Viva-Voce Examination Committee

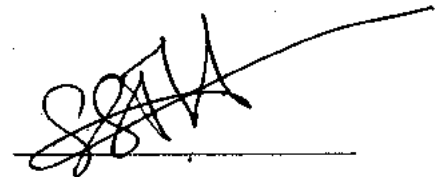
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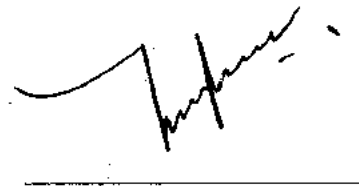
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DEDICATION

To whom I love the most, my parents for their unstinting prayers and invaluable supports

DECLARATION

I, **Muhamad Rifyal Habel Imron**, hereby declare that this dissertation is original and has never been presented in any other institution. Where any of the content presented is the result of input or data from a related collaborative research programme this is duly acknowledged in the text such that it is possible to ascertain how much of the work is my own. Furthermore, I took reasonable care to ensure that the work is original, and, to the best of my knowledge, does not breach copyright law, and has not been taken from other sources except where such work has been cited and acknowledged within the text.

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ABSTRACT

The financial institution, bank or non-bank, play the vital role in maintaining the stability of economy. The improvement of Islamic financial institutions in Indonesia has been growing rapidly. Although BMT (Bait al-Mal wa at-Tamwil) is not recognized as non-bank financial institution, but principally BMT has played its role as intermediating institution to bring together the investor with the needy and manages funds from the rich for the needs of vulnerable people. However, the legal standing status is the biggest problem faced by BMT, particularly in terms of improving service quality for the society.

The alternative form such as Bait al-Mal waa at-Tamwil (BMT) is needed to serve this group. The interesting point of BMT is that institution has any relationship with the Cooperative Departement of Indonesia, because the majority of BMTs are based on cooperative form. There were relevant basic concept relationships between cooperative and BMT management but there was a fundamental different between cooperative and BMTs that is the practice of "Riba".

There is a growing concern with regards to shariah legitimacy of the transactions of BMT. We will study and examine the shariah compliance of BMT and suggest a framework for addressing regulatory issues which impact BMTs operations.

The method of this research is applying normative approach, means to investigate the conformity of cooperative with the Islamic teaching. And the kind of this research is a descriptive analytic.

ACKNOWLEDGMENT

First and above all, I praise God, Allah the almighty for providing me this opportunity and granting me the capability to proceed successfully. It would not have been possible to write this thesis without the help of the kind people around me, to only some of whom it is possible to give particular mention here. I would therefore like to offer my sincere thanks to all of them.

Above all, I would like to thank to my parents, brothers and sisters for their prayer, precious advice, great patience and support throughout as always and encouraging me with their best wishes.

I would like to express my deepest gratitude to my supervisor Prof. Dr. Muhammad Tahir Mansoori (Vice-President Higher Studies & Research, IIUI, Pakistan) for the trust, the insightful discussion, offering valuable advice, for your support during the whole period of study, and especially for your patience and guidance during the writing process. The good advice and support of my second supervisor, Dr. Hendri Tanjung (Assistant Professor, Ibnu-e-Khaldun University, Indonesia) has been invaluable on both an academic and personal level, for which I am extremely grateful. Without their guidance I would never have been able to finish my thesis.

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List of Acronyms

BMT	= Bait al-Maal Wa-Attamwil
PINBUK	= Center for Incubating Small Business
ICMI	= Organization of Indonesian Muslim Intellectuals
AAOIFI	= Accounting Auditing Organization for Islamic Financial Institution
MFIs	= Microfinance Institutions
IDB	= Islamic Development Bank
NGO	= Non-Governmental Organization
BI	= Bank Indonesia
KJKS	= Islamic Financial Services Cooperatives
DSN	= Dewan Syariah Nasional (Shariah National Board)
SMEs	= Small and Medium Enterprises
KUKM	= Minister of Cooperative and Small Medium Enterprises
DEKOPIN	= Indonesian Cooperative Council
BPRS	= Shariah Rural Bank

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Thesis Statement

Although there are few basic similarities between the cooperative department and BMT management in Indonesia but the fundamental difference is that the practice of Riba exists in the legal body of BMTs therefore, the alternative form BMT should be analyzed and criticized in a way that the practice of Riba from the BMTs in Indonesia be removed.

Thesis Introduction

In Indonesia, where more than 90% of all businesses are micro and small enterprises, the question of how to encourage growth and job creation is a vital in reducing vulnerability of poverty.¹ Micro and small business owners frequently remark that their ability to grow is limited by capital constraints. In fact, very few small businesses obtain credit from formal sources. Extending credit to these enterprises is a challenging task. Small businesses suffer from high turnover, low levels of formalization, and borrow relatively small amounts that are expensive for financial institutions to service.

This makes them unattractive to many private commercial lenders, few of whom target small borrowers. Instead, most small business borrowers in Indonesia obtain credit from a variety of microfinance institutions. Microfinance and Islamic finance have much in common. Islam emphasizes ethical, moral, social, and religious factors to promote equality and fairness for the good of society as a whole. Principles encouraging risk sharing, individual rights and duties, property rights, and the sanctity of contracts are all part of the Islamic code underlying the financial system.

In this light, many elements of microfinance are consistent with the broader goals of Islamic finance. Islamic finance advocate entrepreneurship and risk sharing and believe that the poor should take part in such activities. Islamic finance focus on developmental and social goals. Islamic finance advocate financial inclusion, entrepreneurship and risk-sharing through partnership finance and involve participation by the poor.²

¹ <http://www.carlosani.com/home2/main/news-articles/sp803.php>. Accessed on March, 20 2013.

² Ibid

The World Bank had recognized microfinance programme as an approach to address income inequalities and poverty. The microfinance scheme has been proven to be successful in many countries in addressing the problems of poverty. The World Bank has also declared 2005 as the year of microfinance with the aim to expand their poverty eradication campaign. Islamic finance has an important role for furthering socio-economic development of the poor and small (micro) entrepreneurs without charging interest (read: *riba*’).

Furthermore, Islamic financing schemes have moral and ethical attributes that can effectively motivate micro entrepreneurs to thrive. Credit or loan is given for self employment and for financing additional income generating activities. In order to facilitate loan process for the poor, loan is given without collateral or guarantor, and normally is based on trust. Microfinance is an alternative for loan because the conventional banking system recognized the poor as not-credit worthy. Loan facility is provided based on the belief that “people should not go to the bank but bank should go to the people”.³

Islamic microfinance is a new area of interest within both the Islamic finance and microfinance field of study. Theory and practice within this area has been limited, but there appears to be a lot of growing interest in forming an affiliation between the two promising industries. Especially, since they both appear to share many common characteristics like risk sharing, promoting entrepreneurship and striving for economic justice. The concern is that Islamic finance serves mainly bankable people just like most of their conventional counterparts in the banking arena.

It has, to date, primarily ignored the poor or not been very successful in offering Islamic microfinance. Surprisingly though this is in conflict with what Islam teaches, which is to encourage Muslims to offer benevolent loans or to give in acts of charity (*zakah, sadaqah and waqf*). This is not to say that Islamic microfinance has been unsuccessful in Muslim countries, contrary to the belief, there are many successful institutions within these countries, for instance in Indonesia with its BMT which its products rely on shariah principle. Islamic microfinance is an untapped market with huge potential, it has the potential to improve the economy and be socially responsible by helping people who are in desperate need of financial assistance. In accordance with that, the researcher need to analyze the practice of BMT in Indonesia. In this case, the researcher takes the example of BMT in

³ Abdul Rahim Abdul Rahman, “Islamic Microfinance: A Missing Component in Islamic Banking”, *Islamic Area Studies* 1:2 (2007), 38-53.

Tasikmalaya to examine the shariah compliance of BMT also to suggest a framework for addressing regulatory issues which impact BMTs operations.

Literature Review

➤ Conventional Microfinance

Growth in the microfinance industry may be characterized by an increase in the breadth and depth of outreach of existing microfinance institutions, heightened competition among microfinance service providers, diversification of product and service offerings, and the presence of private and commercial funds for microfinance activities. As the microfinance industry develops, these standards become more relevant. A recent study of the Consultative Group to Assist the Poorest (CGAP), a consortium of 29 donors, have shown that world capital markets have been challenged in recent years and that investors are increasingly searching for alternative ways of boosting their returns and spreading their risks.⁴

They have identified that microfinance fits neatly into this trend. With clearer standards, and possibly industry benchmarks and rating systems in the future, interested investors will be better equipped to evaluate microfinance institutions as potential partners for growth. Oikocredit International, a social investor increasingly engaged in microfinance, expressed that channelling commercial capital to microfinance institutions is key in establishing the conditions for sustainability and for the scaling-up of microfinance institutions. Commercial capital pushes microfinance institutions to have more rigorous financial discipline and management.

Outreach and sustainability are two critical objectives for microfinance institutions (MFIs). As defined by Christen et al (1999), outreach is the ability to provide quality financial services to large numbers of people, especially the very poor. Outreach is also an indicator of the institution's social mission to scale up and provide services to as many people as possible. Sustainability, in contrast, requires operating at a level of profitability that allows sustained service delivery without dependence on subsidized inputs. This represents the institution's commercial strategy. For microfinance institutions growth is the process of

⁴ Amando M Tetangco, "Stimulating the growth of microfinance in the Philippines", Central Bank of Philippines. 2005.

balancing the objectives of outreach and sustainability; balancing the social mission and the commercial strategy.⁵

Microfinance, or, provision of financial services to low income households, has come to be accepted almost unquestioningly in the policy circles in developing countries as the most efficacious intervention to alleviate poverty, even as the role of financial markets in poverty alleviation remains as a grossly under-explored area in policy research. Microfinance institutions are those which provide thrift, credit and other financial services and products of very small amounts, mainly to the poor in rural, semi-urban and urban areas for enabling them to raise their income level and improve living standards. Microfinance in India fall under two board sectors: financial and non-financial. Commercial banks, regional rural banks (RRBs) and cooperative banks constitute the formal financial sector. In the non-financial sector, three major organizational forms are observed: (a) not-for-profit MFIs (NGOs, Trusts, and certain forms of Companies); (b) mutual benefit MFIs (state credit cooperatives, national credit cooperatives and mutually aided cooperative); and (c) for profit MFIs (non-banking financial companies).⁶

Anywanu, (2004) observes that microfinance institutions aim to improve the socio-economic conditions of women, especially those in the rural areas through the provision of loan assistance, skills acquisition, reproductive health care service, adult literacy and girl child education. They also aim to build community capacities for wealth creation among enterprising poor people and to promote sustainable livelihood by strengthening rural responsive banking methodology as well as eradicate poverty through the provision of microfinance and skill acquisition development for income generation.⁷

Conventional Microfinance Strategy

The strategy focuses on building financial systems that can grow and provide financial services on a permanent basis to an increasing proportion of the poor, and promotion of pro-

⁵ Ibid.

⁶ Tara S Nair, "Institutionalising Microfinance in India: An Overview of Strategic Issues" journal of economic and political weekly 36:1 (2001), 400.

⁷ Anyanwu, C. M. "Microfinance Institutions in Nigeria: Policy, Practice and Potentials " Central Bank of Nigeria, Abuja, Nigeria (2004).

poor innovations. On the demand side, the strategy supports investments in social intermediation. To play this catalytic role effectively, ADB must:⁸

- provide and leverage its assistance to bring about policy reforms essential for development of microfinance,
- support development of critical financial infrastructure,
- support development of viable MFIs that can set in motion a process of commercialization of microfinance services,
- support social intermediation required for sustainable microfinance development, and
- support innovative programs and financial technology to ensure that the poorest of the poor will also have access to the financial services.

Typically, national microfinance strategies are publicly approved documents, developed through a consultative process, aimed at increasing poor people's access to finance. These strategy documents usually include an overview of microfinance, a vision for the sector, strategic objectives, and an action plan for implementation. Developing a national microfinance strategy usually involves four stages: (i) conducting a diagnostic/gap analysis of the microfinance sector; (ii) consulting with stakeholders (more or less extensively); (iii) drafting a document, usually by a consultant in cooperation with government; and (iv) adopting and implementing the strategy, including approval by a governmental body and, in some cases, defining action steps to put the strategy into practice.⁹

➤ **Islamic Microfinance**

Given the dominance of western culture and values as well as plight and vulnerability of today's Islamic world, there has always been an incessant conflict between the two civilizations. Muslims have always been struggling for decades at almost every walk of real life to retain their values and culture. The philosophy behind such struggle is underpinned in powerful expression of collective identity that is multiple and highly diversified following the contours of each culture and historical formation of each identity. The feeling of this collective identity has urged Muslim scholars to find solutions of current economic problems

⁸ "Finance for the Poor: Microfinance Development Strategy", Asian Development Bank report (2000).

⁹ <http://www.cgap.org/publications/national-microfinance-strategies>. Accessed on April, 21 2013.

to make their lives compatible with Sharī'ah and to safeguard the Muslim Ummah against the perils of the western culture.¹⁰

Islamic financial practices are founded on the core belief that money is not an earning asset in and of itself. The economic aspects of the Islamic banking system can be fully understood only in the context of Islamic attitudes toward ethics, wealth distribution, social and economic justice, and the role of the state. Principles encouraging risk sharing, individual's rights and duties, property rights, and the sanctity of contracts are all part of the Islamic code underlying the banking system. In this light, many elements of microfinance could be considered consistent with the broader goals of Islamic banking.¹¹

Islamic financial services originally operated in an unclear regulatory landscape. However, as they expanded, they presented several regulatory challenges that governments have attempted to address to various degrees. Northern Sudan, for example, adopted Sharia-compliant regulatory frameworks for the entire banking sector in 1984. Indonesia broke new grounding the realm of Islamic finance by creating in 1992 a formal, regulated Sharia banking sector alongside, and not instead of, its conventional banking sector. New regulations in Malaysia, Brunei, and Pakistan also have supported the expansion of an Islamic finance industry along side conventional financial services.

Conventional microfinance products have been very successful in Muslim majority countries. One of the earliest microfinance programs originated in Bangladesh with the experience of the Grameen Bank initiated by Nobel Prize winner Mohammed Yunus. Islamic countries, such as Indonesia and Pakistan, have a vibrant microfinance industry; approximately 44 percent of conventional microfinance clients worldwide reside in Muslim countries. Yet, conventional microfinance products do not fulfill the needs of many Muslim clients. Just as there are mainstream banking clients who demand Islamic financial products, there are also many poor people who insist on these products.

Indeed, Sharia compliance in some societies may be less a religious principle than a cultural one—and even the less religiously observant may prefer Sharia-compliant products. In CGAP's first survey on Islamic microfinance (2008), Islamic microfinance supply was found to be very limited in scale and highly concentrated in only a few countries (80% of the

¹⁰ Yusuf, O., T., "Insurance in Muslim countries: Nigeria's First Takāful Scheme in Focus", *Journal of Islamic Banking and Finance*, International Association of Islamic Banks, Karachi, April – June (2006), 56-63.

¹¹ Nimrah Karim, Michael Tarazi, and Xavier Reille, "Islamic Microfinance: An Emerging Market Niche". Washington, D.C.: CGAP 49:8 (2008), 5.

380,000 clients of Islamic microfinance worldwide were located in Bangladesh, Indonesia, and Afghanistan). Moreover, at that time, Islamic microfinance did not exceed more than 0.5% of total microfinance outreach. In addition to the IFC-commissioned studies, a 2000 Bank Indonesia report indicated that 49 percent of the rural population of East Java considers interest prohibited and would prefer to bank with Sharia-compliant financial institutions.¹²

Contemporary Islamic finance has been largely disengaged from microfinance. On the one hand, most microfinance institutions (MFIs) are not Islamic as their financing is interest based. On the other hand, Islamic financial system has been dominated mainly by Islamic banks.

➤ **Islamic Microfinance in Indonesia.**

Indonesia implements a dual financial system that allows both conventional (mainstream) and Islamic financial system to coexist. In general Islamic microfinance in Indonesia is divided into two categories: banking sectors and non banking sectors. Banking sectors can be categorized as Islamic Banks and Islamic Rural Banks (BPRS). While for non banking systems, they involve Islamic Takaful, Islamic Cooperatives (BMT), and so forth.¹³

The characteristics of Islamic financial institutions in Indonesia by explaining the relationship between various Islamic microfinance institutions in Indonesia and what the roles of Central Bank, Supporting Organizations, to link age of Islamic Banking between banking sectors and non banking sectors as suggested by Bank Muamalat Indonesia (BMI) as BMI Microenterprises Development Program.

In a narrower sense, the term microfinance is applied in Indonesia to a large number of mostly semiformal small local financial institutions, which also include associations of informal SHGs, awaiting the passing of the draft microfinance law of 2001. This was formulated under the auspices of the central bank. Since authority over small financial institutions (Lembaga Keuangan Mikro, LKM) was passed to the Ministry of Finance, no further action has been taken. There is no information how many of these adhere to Islamic principles.

¹² <http://www.cgap.org/publications/islamic-microfinance-emerging-market-niche>. Accessed on January, 09 2015.

¹³ Prof. Dr. Hans Dieter Seibel, *Islamic Microfinance in Indonesia* (Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH, 2005), 1.

The development of Islamic banking has been paralleled by that of Islamic microfinance cooperatives well-known as BMT. The first Islamic cooperative was established in 1990. After 1995, PINBUK started promoting Islamic cooperatives. There were big jumps in numbers during the crisis years 1997–98, followed by a slowing-down, stagnation and decline.

Islamic microfinance institutions in Indonesia may be placed in three categories- the microfinance divisions of Islamic banks, the Islamic rural banks (BPRS) a subcategory of the rural banks (BPR); and the Islamic financial cooperatives that are not part of the formal financial sector. They are generally referred to as BMT. Islamic credit cooperatives BMT are an emerging provider of microfinance in Indonesia. BMTs are often regarded as Islamic micro-financing institutions, with a similar legal basis to cooperatives. BMTs usually operate on the principle of profit-loss sharing instead of charging interest rates, and use Islamic moral values and group solidarity to encourage repayment of loans. Group solidarity is fostered through regular meetings and counseling. BMTs sometimes themselves also run retail businesses to support micro-finance schemes. In Indonesia, the BMT movement has been developing without much support, systematic supervision or regulation from the Indonesian government to date.

The majority of business activities in Indonesia are micro, small and medium enterprises. Their ability to absorb labour means they have great potential to create employment and reduce poverty. But microenterprises have limited access to financial institutions. Consequently, microenterprises need other alternatives to access finance. Microenterprises prefer using BMTs due to their convenience and faster loan approval. As a community financial institution, BMTs offer microenterprises a wider range of services to support their growth such as entrepreneurship training and social empowerment programs.

Islamic microfinance cooperatives suffer from the same regulatory and supervisory neglect as the rest of the sector. There is not much difference between Islamic and conventional cooperatives. At most one-fifth of Islamic cooperatives is in reasonably good health. The rest is dormant or non-performing; most of the remaining ones exist for the purpose of receiving funds from the government. The Ministry of Cooperatives does not

register cooperatives as Islamic or conventional and provides no information on, or special assistance to, Islamic cooperatives.¹⁴

The Islamic cooperatives, BMT, are a recent development, with rapid growth during the first part of the 1990s. Its 2,938 units (as of 2000) constitute 7.2% of all financial cooperatives, 2.8% of deposits and 1.1% of loans outstanding (ADB (2003). The majority of them are incorporated with PINBUK, not with the Ministry of Cooperatives, which has no information on how many of them are incorporated as cooperatives. BI estimates the number of registered BMT at 500 out of a total of 3000.¹⁵

BMTs do not have a uniform legal status. Many BMTs function as informal entities without any distinct legal form. Some others use notarial deed as their legal form. Some small BMTs operate as "pre-cooperatives" certified by the Center for Microenterprise Incubation (PINBUK). Most of medium and large BMTs are however, registered as Islamic Financial Services Cooperatives (KJKS) with the Ministry of Cooperatives and SMEs.

The improvement of Islamic financial institutions in Indonesia has been grown rapidly. The alternative form such as BMT is needed to serve this group. The interesting point of BMT is that institution has any relationship with the Cooperative Department of Indonesia, because the majority of BMTs are based on cooperative form. There were relevant basic concept relationships between cooperative and BMT management but there was a fundamental difference between cooperative and BMTs that is the practice of "Riba".

So, the issue regarding the potential of Islamic microfinance institutions as the tool of poverty alleviation had almost already been discussed in above mentioned books and papers, but the discourse about Shariah appraisal of Bait al-mal wa at-Tamwil (Islamic co-operative) well-known as an Islamic microfinance institution in Indonesia is still required for further investigation.

¹⁴Hans Dieter Seibel, "Islamic Microfinance in Indonesia: The Challenge of Institutional Diversity, Regulation, and Supervision", *Institute of Southeast Asian Studies* 23:1 (2008), 96-97.

¹⁵ *Ibid.*, p. 22

Structure of the Thesis

The research work consists of three chapters given as follows:

Chapter One: Introduction to Islamic Microfinance - It provides an overview with regard to understanding of conventional microfinance and Islamic microfinance with its principles {(prohibition of interest (*riba*), *gharar*, etc)} and modes in the light of *maqasid shariah*. And also it is mentioned here the historical background of BMT which is well-known as the Islamic microfinance institution in Indonesia.

Chapter Two: Islamic Microfinance Institution in Indonesia: Bait al-Mal wa at-Tamwil (analytical study of BMT in Tasikmalaya, West Java) – This chapter focused on the legal and the regulatory contexts, basis principles, products as well as services and its impact on poverty alleviation in Tasikmalaya, Indonesia. In this case, we take the example of BMT in Tasikmalaya, West Java.

Chapter Three: Shariah and Legal Analysis of The Operation of Cooperative Corporation For BMT – This is the last chapter of the research which provide firstly, Cooperative Law regarding BMTS in Islamic Perspective, Conformity of cooperative principle with Islamic Cooperative. Secondly, Critical Analysis of BMT Institution Legal Body.

Ultimately, it is a conclusion which presents the summary of the research and followed by some recommendations which are the prominent result of the inquiry.

Research Methodology

The research follows both qualitative and quantitative methods in which primary data and information has been gathered from interviews with beneficiaries through e-mail, and opinions of ulama on operations of BMTs have also been sought. While different journals, articles, library, research papers and technological sources have been applied to seek all available related to secondary data, modern or contemporary books have also been applied as reference for obtaining required information.

INTRODUCTION TO ISLAMIC MICROFINANCE

1.1 Microfinance defined

Microfinance has evolved as an economic development approach intended to benefit low-income women and men, the term refers to the provision of financial services to low-income clients, including the self-employed.¹⁶ Microfinance is also known as the activity or business of providing financial services, such as small loans, to poor people or new businesses that cannot use traditional banking services, usually in developing countries¹⁷. Microfinance aims to help the poor and the needy, a wide variety of life in this world. Financial service generally includes savings, credit, insurance and payment services flown to assist the poor. Microfinance clients are typically self-employed, low-income entrepreneurs in both urban and rural areas. Microfinance, or provision of financial services to low income households, has come to be accepted in the policy circles in developing countries and has a prominent role in alleviating and eradicating poverty.

According to the accepted definition, microfinance institutions are those which provide thrift, credit and other financial services and products of very small amounts, mainly to the poor in rural, semi-urban and urban areas for enabling them to raise their income level and improve living standard.¹⁸

Microfinance activities usually involve:¹⁹

- Small loans, typically for working capital
- Informal appraisal of borrowers and investments
- Collateral substitutes, such as group guarantees or compulsory savings
- Access to repeat and larger loans, based on repayment performance
- Streamlined loan disbursement and monitoring

¹⁶Joanna Ledgerwood, *Microfinance handbook: an institutional and financial perspective* (Washington: The world bank, 1998), p. 1.

¹⁷See <http://dictionary.cambridge.org/dictionary/business-english/microfinance>. Accessed on desember 10, 2013.

¹⁸Tara S.Nair, "Economic and Palitical Weekly, Vol. 36, No. 4, Money, Banking & Finance", (Jan. 27-Feb. 2, 2001), pp. 399-404.

¹⁹Joanna Ledgerwood, *Op. Cit*, p. 2-4.

- Secure savings products.

MFIs can be non governmental organizations (NGOs), savings and loan cooperatives, credit unions, government, banks, commercial banks, or nonbank financial institutions. One of the clearest framework of microfinance has been put forward by. In a wider sense, they may also comprise national Prof. Dr. H. D. Seibel (2001), who defines microfinance as: "A sector of formal and non-formal financial institutions providing micro saving, micro credit and micro insurance services to the micro economy, thereby allocating scarce resources to micro investments with the highest rates of return. In a narrow sense, microfinance institutions are small local financial institutions or regional banks with microfinance services for small savers and borrowers".²⁰ Among the features of microfinance is the disbursement of small size loan to the recipients that are normally micro entrepreneurs and the poor.²¹ It means that the loans are given to them under the purpose of generating income from new projects or business expansion.

Credit or loan is given for self employment and for financing additional income generating activities. As currently, microfinance has emerged as an important instrument to help a large number of "unbankable" members of society, as a tool to help reduce poverty and encourage economic growth in neglected parts of the world.²² Most of microfinance institutions have non-Islamic characteristics such as charging interest on financing. Conventional microfinance institutions have often been criticized for charging the poor and needy with a high interest and fees.

There are not many Islamic microfinance institutions and they exist only in a few countries. These institutions largely use the group based lending format of the conventional microfinance Institutions and adapted Islamic principles and values. While utilizing various Islamic modes of financing, they usually encounter difficulty in obtaining funds from external sources. While some funds are available from government agencies, they are often subjected to terms and conditions that are not in compliance with Islamic principles.²³

²⁰Hans Dieter Seibel, Op. Cit

²¹*Ibid.*, p. 15

²²Joanna Ledgerwood, Op. Cit, p. 18

²³ Abdul Rahim Abdul Rahman, "Islamic Microfinance: A Missing Component in Islamic Banking", *Kyoto Bulletin of Islamic Area Studies*, (2007)1-2, p. 38-53.

Issues in Microfinance

Microfinance activities based on best practices play a decisive role in providing the poor with access to financial services through sustainable institutions. There are certain issues involved in their programs that hamper their growth and success:

- Some MFIs target a segment of the population that has no access to business opportunities because of lack of markets, inputs, and demand. Productive credit is of no use to such people without other inputs.
- Many MFIs never reach either the minimal scale or the efficiency necessary to cover costs.
- Many MFIs face nonsupportive policy frameworks and daunting physical, social, and economic challenges.
- Some MFIs fail to manage their funds adequately enough to meet future cash needs and, as a result, they confront a liquidity problem.
- Others develop neither the financial management systems, nor the skills required to run a successful operation.
- Replication of successful models has at times proved difficult, due to differences in social contexts and lack of local adaptation.²⁴

1.2 Islamic Microfinance

Microfinance and Islamic microfinance have much in common. Both have a similar missions i.e. to alleviate poverty and enhance prosperity in the society. Many elements of microfinance are consistent with the broader goals of Islamic finance. Both advocate entrepreneurship and risk sharing and believe that the poor should take part in such activities. Both focus on developmental and social goals. Both advocate financial inclusion, entrepreneurship and risk-sharing through partnership finance. Both involve participation by the poor.²⁵

²⁴Joanna Ledgerwood, Op. Cit, p. 4.

²⁵Rahul Dhumale and Amela Sapcanin, "An application of Islamic Banking principles to microfinance", technical note, regional bureau for Arab State, UNDP.

Islamic Microfinance is usually understood to embrace the provision of financial services to small businesses and micro-entrepreneurs, which lack access to banking and related services due to the high transaction costs. There are two main mechanisms for the delivery of financial assistance:

- a. relationship-based banking for individual small businesses and entrepreneurs.
- b. group-based models, where several small business and entrepreneurs come together to make loans and other services as a group.

Islamic microfinance represents the confluence of two rapidly growing industries: microfinance and Islamic finance. It has the potential to not only respond to unmet demand but also to combine the Islamic social principle of caring for the less fortunate with microfinance's power to provide financial access to the poor.²⁶ Islamic microfinance in its framework could help improve the standard of living of low-income earners and the poor because it discourages exploitation and achieves an objective of social justice.

There are a variety of Islamic products that can be adapted to microfinance in order to reduce the scourge of poverty in the country. In various countries in the Middle East where the microfinance concepts have been implemented, microfinance has successfully opened economic opportunities improving the social economic condition of the poor, which attests to the fact that microfinance reduces poverty through accelerated employment rate and increase in real wages.

1.2.1 Characteristics of Islamic Microfinance

The Islamic microfinance system is based on justice, equity and welfare. Islamic microfinance seeks to enhance economic conditions with a broad-based economic well-being with full employment and an optimum rate of economic growth. It brings socio-economic justice and equitable distribution of income and wealth. The Islamic microfinance system is based on the Shariah Law. The Shariah is derived from two primary Sources of Islamic law, namely the divine revelations set forth in the Qur'an and the sayings and example set by Prophet Muhammad in the *Sunnah*. Islamic Jurisprudence interprets and extends the application of Shariah to questions not directly addressed in the primary sources by including

²⁶ Karim, *Ibid.*, p. 1

secondary sources. These secondary sources usually include the consensus of the religious scholars embodied in *ijma*, analogy, *istihsan* (juristic preference), *maslahah mursalah* (public interest), '*Urf* (custom), etc.

The most widely known characteristic of the Islamic financial system is the strict prohibition of giving or receiving any fixed, predetermined return on lending transactions. Since the Islamic microfinance Institution ensures that all transactions and services must be in accordance with Shariah, and the objectives of Shariah also known as *Maqasid al-Shariah*. The principles advocated by the Shariah ensure that the Islamic microfinance transactions are just, transparent and prohibit involvement in illegal and illicit activities that are detrimental to society.

1.2.2 Basic principles of Islamic microfinance

1. Prohibition of usury (riba)²⁷ traditionally occurred in lending or savings as a fixed return or without participation in the specific risk exposure and thus an unfair practice. All forms of contracts and transaction must be free from riba. The Quran declares:
 - a. *“Allah has permitted trade and forbidden riba”*. (al-baqarah: 275).
 - b. *Allah will deprive riba of all blessing, but will give increase for deeds of charity: and Allah does not love the ungrateful and unjust*. (al-baqarah: 276).
 - c. And the Prophet Muhammad (PBUH) also pays attention to this regard by saying: *“Every loan entails benefit is Riba”*.

Interest at low or high is strongly rejected by Muslim religion and it is a violation of Shariah teaching. Modern researches have shown that interest has bad consequences for the economy and it becomes an obstacle of economic growth. It results in an inefficient allocation of society's resources. It contributes to the instability of the system. Also, it increases the inequality in the distribution of income and wealth as it guarantees a continuous increase in the monies lent out, mostly by the wealthy, and caused the burden of bearing the

²⁷ Literally, it means increase or addition or growth. Technically it refers to the 'loan' that must be paid by the borrower to the lender along with an excess payment and the principal amount as a condition for the loan or an extension in its maturity. Interest as commonly known today is regarded by a predominant majority of fuqaha to be equivalent to riba.

losses on entrepreneurs through loss of jobs, and loss of self-esteem for the workers. Islamic economics research has shown that the economic system can function without interest.

The eradication of interest or *riba* does not mean that the financier cannot earn profit from commercial transaction, he can use the concept of profit and loss sharing modes where possible and trade based modes, e.g. *murabahah*, *mudharabah*. Where necessary, will be more efficient, more equitable, and more stable than the current interest based system. The profit sharing arrangement may either involve the money owner in management, in which case it becomes a partnership, or it may leave management to the one taking the money or a worker. in which case we call it *mudarabah*. In both cases the money owner shares the resulting profits in proportions agreed in advance. But in both cases the investor bears the loss incapital if and when it occurs. However, the entrepreneur becomes liable to loss in capital if he or she violates the terms of agreement regarding the nature and scope of business, etc.

The holy Quran declares trade to be lawful means of livelihood as opposed to *riba*, is forbidden from being oppressive and exploitative. It exhorts believers to shun *riba* and embrace charity. The exact nature of *riba* has been extensively discussed in Islamic literature. *Riba* in a loan or debt contract exists when it stipulates an excess in repayment by the borrower. An excess payment that is not a part of the contract and paid voluntarily by the borrower is not *riba*. There is a general agreement on modern interest being a form of the forbidden *riba*. The presence of interest makes most conventional financial contracts, unlawful and unacceptable in Islamic microfinance.²⁸ In other example of *riba* in Microfinance i.e. lending and selling concurrently, it is where a person lends money, on the condition that the borrower will sell a certain commodity, at a certain price to the creditor, or he will buy certain goods at a certain price from the lender. This is not allowed, because through such stipulation, he intends to derive some extra benefit for himself from this loan. The holly prophet (s.a.w.s) has strictly prohibited this practice.²⁹

²⁸Mohammed Obaidullah, *Introduction to Islamic Microfinance* (India: International Institute of Islamic Business and Finance, 2008) p. 20.

²⁹Dr. Muhammad Tahir Mansoori, *Shari'ah Maxim: Modern Applications in Islamic Finance* (Islamabad: Islamic Research Institute Press, IIUI, 2012) p. 213.

2. Transactions or activities should be in *halal* manner.

Shariah does not allow for every muslim to get involved in *haram* manner such as *khamr* (alcohol), corpse, bacon. Shariah comes to bring human beings into sacred soul and body, free from the unlawful manner, and it also does not allow to get involved on such profits arising from immoral activities. For instance, investing in business dealing with night clubs and casinos infested gambling, pornography, or weapons of mass destruction. As the Quran declares:

- O ye who believe! Intoxicants and gambling, (dedication of) stones, and (divination by) arrows, are an abomination of Satan's handiwork: Eschew such (abomination), that ye may prosper. (*Al-maidah*: 90)
- O ye who believe! Make not unlawful the good things which Allah hath made lawful for you. (*Al-maidah*: 87).

From the above mentioned, it is clear that Islam is strictly prohibiting any illicit and illegal transaction that has no benefit and detrimental for the society. Therefore, IMF emerged as a program and a tool to eliminate and abolish the illicit transaction. IMF promotes Shariah transactions based.

3. Prohibition of *Gharar*.

Gharar is one of the major vitiating factors of transactions in Islamic law. It especially affects, the validity of commutative contracts, (*'uqud al-mu'awadat* such as sale, hiring and leasing contract). *Gharar* refers to uncertainty, and lack of knowledge about necessary terms of contract, which may lead to dispute and litigation.³⁰ According to Sarakhsi: "*Gharar* takes place where the consequences (of a transaction), remains unknown".³¹

The rules of shariah regarding *gharar* have been described by the shariah scholars through certain maxim, the most prominent of such maxims are as follows:

- A *gharar*, when found in the principal object of contract, renders it invalid.
- *Gharar* invalidates commutative contracts, not gratuitous contracts.
- A trifling *gharar*, which is not related to a principal object, is permissible.³²

³⁰ Mansoori, *Ibid.*, p. 187

³¹ Sarakhsi, *al-mabsut* (Beirut: Dar al-ma'arif, vol. 13,1978), p. 194.

³² Mansoori, *Op.Cit.*, p. 191

The example of *gharar* in microfinance transaction such as incompatibility of commodity with the customer's demand in *murabahah* contract, or in *ijarah* contract where the leased commodity is not in accordance with the agreement of contract such as the existence of defective commodity, damage, etc. Or in *Musharakah* and *Mudharabah* where there is deception in profit and loss sharing proportion.

4. Principle of Social Welfare, Justice and *Kafalat-e-ammah*

The Muslim ummah is the one who implement the teachings of Islam and worship in accordance with Shariah, ethics, and behavior that has been outlined in the Quran and Hadist. When the ummah are committing to this rule, the social welfare and justice will be embedded in the society, so that, all intense and goals of this rule can be achieved. The social welfare in Islam is not physically intended to take advantage, although there are important pillars in it but to exceed the needs of all community for both individually and groups, physical needs or intellectual needs, thus includes all the basic individual rights and the groups within the Muslim ummah.

It is worthy to note that the ultimate goal of Islamic microfinance modalities is to ensure growth with equity based for social welfare and justice. Without social welfare and justice, there will arise gap and class conflict which will result in the subsequent inability to achieve peace, harmony, prosperity and development. Islamic microfinance emphasized like other aspects of Shariah generally, it impacts the importance of human interactions and structure of the framework as well as impacts moral and ethics among the community. Islamic microfinance with its characteristics significantly deal with the fields "ethical investment methods" and "social institution's responsibility" These two fields are characterized by an increasing of popularity growth all over the world. People are increasingly aware of the importance of learning on how touse their wealth and the sources that come from the profits of their wealth.

Allah declares in holly Qur'an:

وَالَّذِينَ فِي أَمْوَالِهِمْ حَقٌّ مَّعْلُومٌ لِّلسَّائِلِ وَالْمَحْرُومِ

“And those in whose wealth is a recognized right. For the (needy) who ask and him who is prevented (for some reason from asking).”³³

From the verse mentioned above, it can be concluded that the concept of achieving social welfare is *Haq-el-ma'lum*, its mean to allocate the wealth for the needy through *zakah*, *infaq* and *shadaqa*. This is the responsibility of the state for the welfare of its people's prosperity and social well-being. Ensuring financial services to poor people is best done by expanding the number of Islamic financial institutions available to them, as well as by reinforcing the capacity of those institutions.

In addition to that, every rich people has to contribute their role in this life i.e. distributing their wealth to the people who are in desperate need of financial assistances. The rich stand as a spear to sustain the needy and to build up their economy. The rich can distribute their wealth through IMFIs or institutional bodies taking care of the poor and the needy, it will manage and allocate *zakah*, *infaq* and *shadaqa* to them.

5. Equitable Distribution of Wealth.

From the above mentioned before, it should be noted that the goal of Islamic microfinance is to achieve social welfare cannot succeed without equitable distribution of wealth, the distribution should be impartial. Every needy and poor people should have their rights i.e. 2.5 % of *zakah* portion. Islam not only requires the fulfillment of everyone's basic needs, primarily through a admirable source of earning, but also emphasizes an equitable distribution of wealth and income, in the words of the Holy Qur'an, “Wealth does not circulate only among your rich.”³⁴

Economic empowerment is much wider than enhancement of income. It aims at social transformation of the needy and the poor, also to ensure social justice by applying the principle of the equality of all individuals in the eyes of the law and by providing equal opportunity for all without discrimination. The objective of equitable distribution of wealth:

a. The establishment of a practical system of economy

The first object of the distribution of wealth is that it would be the means of establishing in the world a system of economy which is natural and practicable, and which, without using

³³Al-Ma'arj, verse: 24-25.

³⁴A-Hashr, verse: 7.

any compulsion or force, allows every individual to function in a normal way according to his ability, his aptitude, his own choice and liking, so that his activities may be more fruitful, healthy and useful. And this cannot be secured without a healthy relationship between the employer and the employee, and without the proper utilization of the natural force of supply and demand. That is why Islam does admit these factors.

b. Enabling everyone to get what is rightfully due to him

The second object of the Islamic system of the distribution of wealth is to enable every one to get what is rightfully his. The basic principle of Islam in this respect is that wealth is in principle the property of Allah Himself and He alone can lay down the rules as to how it is to be used. So, according to the Islamic point of view, not only those who have directly participated in the production of wealth but those to whom Allah has made it obligatory upon others to help, are the legitimate sharers in wealth. Hence, the poor, helpless, the needy, the paupers, and the destitute— they have a right to wealth.

c. Eradicating the concentration of wealth

The third object of the distribution of wealth, which Islam considers to be very important, is that wealth, instead of becoming concentrated in a few hands, should be allowed to circulate in the society as widely as possible, so that the distinction between the rich and the poor should be narrowed down as far as is natural and practicable.³⁵

6. Asset Based Financing

Asset based financing is a specialized technique of providing structured working capital and term loans which are tenable by accounts receivable, machinery, inventory, equipment, and real estate. Putting another way, asset based financing is a means for fast growing, cash-strapped business entities to congregate to their short term cash requirements.³⁶ The main benefit of asset based financing is that small and medium enterprises are able to get more cash faster than they could have got from a conventional microfinance loan. Another advantage of asset based financing is that factors and asset based lenders proffer wide ranging services together with accounts receivable processing, collections, invoicing as well as it can prevent diversion of funds for consumption.

³⁵Mufti Muhammad Shafi, *"Distribution of Wealth in Islam"*. Translated by Muhammad Hasan Askari, [Paper presented at the International Islamic Conference, Rawalpindi, Pakistan, 1968].

³⁶<http://www.investopedia.com/terms/a/assetbasedfinance.asp>. Accessed on January, 09 2015.

The Islamic microfinance also faced the lack of debt-based products initially but quickly innovated asset-based financing products, where the IMFI would purchase the asset desired by their customers from the market and then sell these assets against a pre-agreed revenue stream. As the price represents cost-plus-profit, the IMFI is able to earn some margin. The product is known as “*murabaha* with deferred sale price” and, with its other variations, is the most popular product offered by the IMFI³⁷.

1.2.3 Modes of Islamic microfinance

A number of Shariah compliant financial products and modes which are commonly used in the mainstream Islamic finance industry could also be used in the provision of Shariah compliant microfinance products and services there are the following:

a) Profit sharing

i. *Musharakah* (partnership)

Musharaka involves investors based on an equity into a business venture and sharing any profits and losses from that venture according to predetermined ratios. *Musharaka* is a relationship established by the parties through a mutual contract. It is an ideal alternative for the interest-based financing with far reaching effects on both production and distribution. The legal evidences of *musharaka* is the Qura'nic verse “*Verily many are the partners in business who wrong each other except those who believe and work deeds of righteousness and how few are they*”.³⁸ Besides, it is narrated in the sunnah that Al-sa'ib ibn Abi Al-sa'ib al-Makhzumi was a partner of the prophet (PBUH) in business at the beginning of Islam. The partnership is recognized as one of primary transactions practiced by the Muslims since the advent of Islam indicating that the validity and permissibility of the Islamic partnership is based in its practical consensus since the time of Prophet Muhammad (PBUH).³⁹

³⁷ <http://www.cgap.org/blog/can-islamic-banking-offer-some-lessons-islamic-microfinance>. Accessed on January, 18 2015.

³⁸ Al-qur'an, al-sad: 24.

³⁹ See, AAOIFI, 2003, Standard on *Musharaka*, p. 218.

The basic Rules and Features of *Musharakah*

- Profits shall be distributed in the proportion mutually agreed in the contract between the parties.
- It is not allowed to fix a lump sum amount for any of the partners, or any rate of profit tied up with his capital. A management fee however, can be paid to the partner managing the *Musharakah* provided the agreement for the payment of such fee is independent of the *Musharakah* agreement.
- Losses are shared by all partners in proportion to their capital.
- All assets of *Musharakah* are jointly owned in proportion to the capital of each partner.
- All partners must contribute their capital in terms of money or species at an agreed valuation.
- Share capital in a *Musharakah* can be contributed either in cash or in the form of commodities. In the latter case, the market value of the commodities shall determine the share of the partner in the capital.
- The rate of profit sharing should be determined: The share of each partner in the profit earned should be identified at the time of the contract.⁴⁰

Distribution of Profit

- The proportion of profit to be distributed between the partners must be agreed and determined upon at the time before conducting the contract. If no such proportion has been determined, the contract is not valid (*bathil*) in Shariah.
- The ratio of profit for each partner must be determined in proportion to the actual profit accrued to the business, and not in proportion to the capital invested by him. It

⁴⁰Dr. Muhammad Zubair Usmani, "Sharia Advisor Muslim Commercial Bank Ltd. Jamia Darul Uloom Karachi". (Presented at: AlHuda CIBE Workshop at NIBAF – State Bank of Pakistan, Islamabad).

is not allowed to fix a lump sum amount for any one of the partners, or any rate of profit tied up with his investment.⁴¹

It must be expressly mentioned in the agreement that the dispute is settled in the end of the contract.

Sharing of Loss

In the case of a loss, all the Muslim jurists are unanimous on the point that each partner shall suffer the loss according to the ratio of investment. Hence, if a partner have invested 40% of the capital, he must suffer 40% of the loss not more, not less, and any condition contrary to its rule shall render the contract invalid. This principle is famous mentioned in shariah maxim:

*Profit is based on the agreement of the parties, but loss is always subject to the ratio of investment.*⁴²

The structure of *musharakah* might be depicted as the given below:

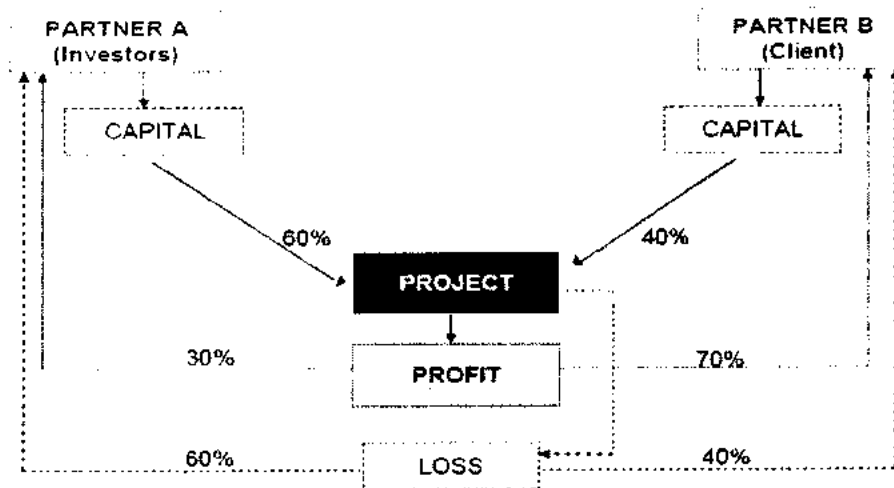


Figure 1: Musharakah structure

⁴¹Usmani, Op.cit, p. 23

⁴²Usmani, Op.cit, p. 25

ii. **Mudharabah** (trust financing)

Mudharabah is a contract between a capital provider (*sahib al-mal*) and an entrepreneur (*mudharib*) in which the former contributes the capital and the latter contributes his effort in managing the business. The parties will share the business profit according to an agreed ratio. However, if the business incurs loss, it shall be borne by the capital provider alone while the entrepreneur would have just wasted his time and efforts.⁴³ According to Al-Jarjani of the Hanafi school, *mudharabah* is a profit sharing contract with capital from one side and work from the other. It is initially deemed as a *wadiyah*, then a *wakalah* while the business is in progress and finally a partnership upon accrual of profits.⁴⁴ Under a *mudharabah* contract the IMFIs provides the capital needed by the entrepreneur for projects and offers labor and expertise. The profits (or losses) from the project are shared between the IMFIs and the entrepreneur according to a predetermined agreed ratio. Financial losses are born entirely by the IMFIs as *sahib al-mal*, the liability of entrepreneurs is limited to their skill and effort. In case of proven negligence or misconduct by entrepreneurs however, they may be taken responsible for the financial losses.

Islam has recognized it as a contract which is in line with its principles. Although *mudharabah* consist of an element of *jahalah*, it is still allowed since it facilitates business and trade for the community.⁴⁵ *Mudharabah* contracts are divided into two categories:

- **Unrestricted Mudharabah contract (*Mudharabah Mutlaqah*)** is a contract in which the capital provider permits the *mudharib* to administer a *Mudharabah* fund without any restriction. In this case, the *mudharib* has a wide range of trade or business freedom on the basis of trust and the business expertise he has acquired.
- **Restricted Mudharabah contract (*Mudharabah Muqayyadah*)** is a contract in which the capital provider restricts the action of the *mudharib* to a particular location or to a particular type of investment as the capital provider considers appropriate, but not in manner that would unduly constrain the *mudharib* in his operations.⁴⁶

⁴³Wahbah al-Zuhaili, "*Fiqh al-Islami wa Adillatuhu*", (Beirut: Dar al-Fikr, v. 5, 2006), p. 3924.

⁴⁴Abdul Hamid Mahmud Tohmaz, "*Fiqh al-Hanafi fi Tha'ubih al-Jadid*", v. 5, p. 67.

⁴⁵Ibn Rushd, "*Bidayah al-Mujtahid*", (Dar Ihya' al-Turath al-Arabi, Beirut, 1992, v. 2), p. 303.

⁴⁶See, AAOIFI, 2010, Shariah Standard No. (13) on Mudaraba, p. 236.

These type of contracts are most common used in investment projects in trade and commerce. The contract between the IMFI and the entrepreneur is known as restricted *mudharabah* because the IMFI agree to finance specific investments by specific entrepreneurs and to share relative profits according to and agreed percentage. To engage in *mudharabah* transactions, IMFI must meet the following obligations:

- The IMFI should not request collateral to reduce its credit risk on these transactions, and thus bears the entire financial risk. Collateral may, however be requested to reduce moral hazard.
- Profit sharing rates must be determined only as a percentage of the profit, not a lump sum payment. In some cases the IMFI may receive part of the principal from the borrower at the end of the period if a surplus exists. In cases of loss, the entrepreneur will not be liable unless found guilty of negligence of mismanagement.
- The entrepreneur exercises full control over the business; however supervision by the IMFI is permitted.⁴⁷

Rules regarding remuneration and profit sharing

- a. All parties must agree, on a definite proportion of the actual profit to which each one of them is entitled to.
- b. If nothing explicitly mentioned then it presumed that each of the parties will get exactly the same proportion of the profits.
- c. Incentives may be given to the *mudharib* as bonus. To encourage positive behavior such achieving specified target on aforementioned criteria.
- d. Apart from the agreed profit share, *Mudharib* cannot claim any periodical salary, fee or remuneration for the work done from the *mudharabah*.
- e. The parties cannot allocate a lump sum amount of profit for either of them neither can they determine the share of any party at a specific rate tied with the capital invested.

⁴⁷ Mohammed Khaled, "Building a Successful Business Model for Islamic Microfinance", MENA Regional Representative, The Consultative Group to Assist the Poor (CGAP), June 2011.

Differences between *Musharakah* and *Mudharabah*

There are many similarity between *musharakah* and *mudharabah* arrangement, the following table outline some fundamental differences between the two:

	<i>Musharakah</i>	<i>Mudharabah</i>
Investment	✓ Comes from all parties	✓ Sole responsibility of <i>Rab al-mal</i>
Management	✓ All partners participate in management	✓ <i>Rab al-mal</i> has no right to participate in management
Liability	✓ Liability of partners is unlimited	✓ <i>Rab al-mal</i> is liable to the extent of his investment ✓ <i>Rab al-mal</i> incurs financial loss, <i>mudharib</i> loses his efforts
Capital Appreciation	✓ All partners can benefit from profit gained through appreciation in value of investment	✓ An appreciation of the investment goes to <i>Rab al-mal</i>

The structure of *mudharabah* might be described as the given below:

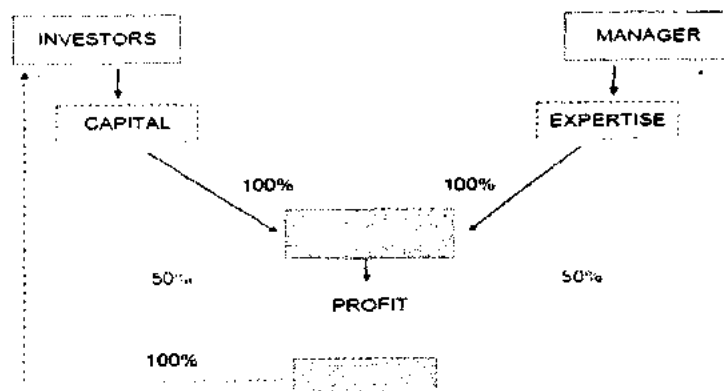


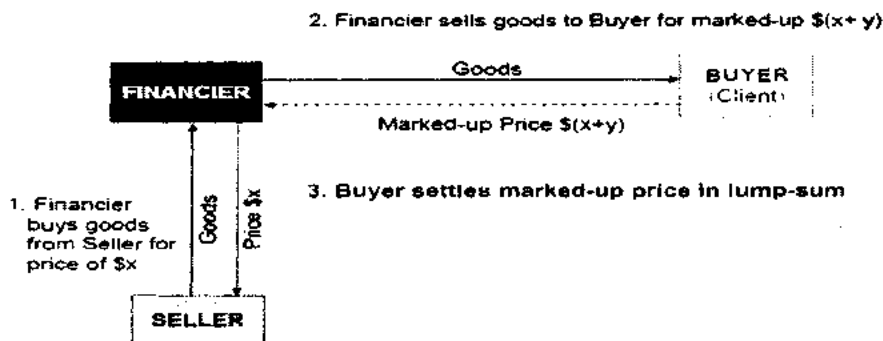
Figure 2: *Mudharabah* structure

b) Contracts of exchange.

i. *Murabahah* (cost-plus mark-up)

Murabahah is a familiar term in Islamic law in respect of commercial transaction. The term is expressed by the muslim jurist in various definitions through it reveals a single sense of meaning, that is a sale on the basis of actual cost plus a profit margin.⁴⁸ *Murabahah* is a particular kind of sale with the seller expressly discloses their own cost in requiring the goods is being sold when selling to another person, an agreed profit mark-up is added to this cost by the seller.

According to Islamic classical sources, it is simply considered as a part of sale contract (*bay'*) with all its implications prescribed by Shari'ah pertaining to sale. Specifically, it is a trust sale (*amanah*) as the purchaser relies upon the sincerity of the seller with regard to the actual price mentions to the purchaser. However, in the classical sense of *Murabahah*, the contract is between two-sided parties, buyer and seller, and no third entity is involved. The buyer would purchase the commodity directly from the seller on cost plus mark up basis as per rules prescribed by Islamic Shari'ah. So, initially it has no colleration with financing activity as it occurs in the current practical operation. But further, with the arising of dynamic circumstances of human atmospheres and the necessity to meet their different needs, and also to provide the Shari'ah compliant alternative to interest-based financing, it is observed that such mode of *murabahah* financing is necessary to be established without neglecting another approved form of *musharakah* and *mudharabah*.⁴⁹ The structure of *murabahah* might be depicted as the given bellow:



⁴⁸See, 'Alau al-Din Abi Bakr bin Mas'ud al-Kasani, "*Badai'u al-Sana'i fi Tartibi al-shar'i*", (Cairo: Sharikat al-Matbuat al-Islamiyah, vol. 7), p. 93; Muhammad Khatib al-Sharbini, "*Mughni al-Muhtaj*", (Beirut: Daar al-Ma'arif, vol. 2), p. 102.

⁴⁹However, trade or sale is ideally preferred as it is mentioned in the Qur'an 2:275 that Allah has permitted trade and forbidden riba.

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Rules Regarding *Murabahah* Contract

As a contract of sale, definitely it must comply and accordance with the requirement of its originality, being a sale contract. It is enumerated below the conditions on which a valid sale can be attained in the light of Shariah. These comprise the following four elements which are subjected to its own conditions in a sale, i.e.:

1. Conditions for the subject matter of contract:

- The subject matter should be lawful. The commodity like pork wine carrion, etc is not allowed according to this principle.
- The commodity should exist at the time of making contract or it should be capable of being delivered in future.
- The commodity should have been acquired by the seller. Meaning by that is the subject matter should have come into the possession of the seller, either physically or constructively. Constructive possession is when the goods are under his control and all rights and liabilities of the goods have passed on to him though he has not taken physical delivery of the goods. However, there are two exceptions in this issue: one is in *Salam*, and the other is *Istishna*'.
- The commodity should be ascertained and known by both contracting parties. So both parties precisely examine and determine the object of the contract with regard to its value, essence and quantity.⁵⁰

2. Additional conditions specifically pertaining *Murabahah*

- The fixed cost must be known to the buyer.
- The additional mark-up as a profit is fixed and also must be mentioned in the contract.
- The first contract must be valid.

⁵⁰*Ibid.*, p. 41

ii. *Ijarah*

Ijarah is an Islamic leasing contract to representing the one of the most common modes of Islamic finance currently practiced. Its popularity due to strong powerload to conventional leasing structures and it is therefore an easily understood concept that is relatively straight forward to implement. It represents a legal contract where the owner of something which has interesting value with transfers its usufruct to a third party for an agreed period, at an agreed consideration.

Ijarah is a term of Islamic fiqh. Lexically, it means 'to give something on rent'. In the Islamic jurisprudence, the term *ijarah* is used for two different situations. In the first place, it means to employ the services of a person on wages given to him as a consideration for his hired services.⁵¹ According to Hanafi school *ijarah* is a contract wich enables to possess of a particular intended usufruct of the leased asset for a consideration. Maliki school defined it as a contract which relates to permissible usufructs for a particular period and a particular consideration not arising from usufruct. Shafie school defined it as a contract for a defined intended usufruct liable to utilization and accessibility for a particular recompense. While Hambali school defined it as a contract for a particular permissible usufruct which is taken gradually for a particular period and a particular consideration.⁵²

Ijarah is used to serve as a mode of microfinance. All kinds of income generating equipment or physical asset such as, lands, tools and machines to manufacture commodities, cars to make a transport, and all kinds of people's needs may be financed through this mode for the poor and poorest. An important Shariah rule governing *ijarah* as a tool of microfinance is that the risk emerging from the ownership of the asset substantially borne by the lessor. In a conventional financial lease, the lessor transfers substantially the risks and all incidental or destruction of the leased assets are borne by the lessee even while the commodity of the leased may or may not be transferred to the lessee. The complete results of this transfer is unacceptable from the Shariah point of view.

In Islamic leasing or *ijarah*, the leased asset or commodity remains as *amanah* or in trust with le lessee. There is no compensation in *amanah* in case of destruction of the value, except when the loss is caused due to negligence and dereliction of the lessee. Thus, the leased asset

⁵¹*Op.Cit*, p. 109.

⁵²Abdul Rahman al-Jaziri, *al-Fiqh 'Ala al-Mazahib al-Arba'ah*, (Beirut: Dar al-Ihya al-Turath al-'Arabi, Vol. 2), p. 95-98.

remains in the risk of the lessor throughout *ijarah* in definite period, in case of any loss, damage or caused by the factors beyond the control of the lessee shall be borne by the lessor.

In this sense, *ijarah* is different from conventional leasing. Agreements of conventional financial lease generally do not differentiate between the two situations. In an *ijarah*, both situations are to be dealt with separately. A lessor can, of course, mitigate his risk by making the lessee specifically liable for damages, theft and/or loss on destruction of assets except in the case of force majeure. Further, specific risks of the lessor relating to the physical damage, theft and/or loss on destruction of the leased asset may be covered by Islamic insurance or *takaful*. The lessor of IMFI may include the cost of *takaful* premium in the *ijarah* rental. Any escalation in the *takaful* premium may also trigger rent adjustment if it is specified in the *ijarah*.⁵³

Ijarah is similar to micro-leasing which is offered by conventional microfinance. In *ijarah* transaction, an IMFI buys the asset which is needed by the client and then lease it back to the client. As a lessor, the IMFI owns the ownership right of the asset and the micro-entrepreneur as the lessee should pay the rental which has been agreed between both parties in advance prior to definite period. At the end of leasing period, the micro-entrepreneur can return back the asset or purchase it from the IMFI.

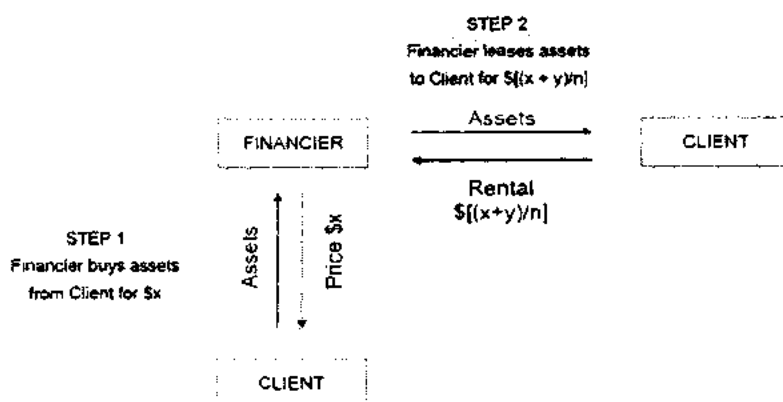


Figure 4: *Ijarah* structure

⁵³*Ibid.*, p. 50.

Basic Principles of Ijarah

a). Parties:

- It is possible for the lessee to have been the one who sold the asset to the IMFI in the first transaction and subsequently lease the asset back from Islamic IMFI on condition that transactions are independent from each other.
- The lessee can be a co-owner in the leased asset with the lessor.

b). Subject matter:

- Must have a value and must be specifically identified and quantified to avoid any ambiguity in the contract.
- The corpus of leased asset should remain in the ownership of the lessor and only the usufruct be transferred to the lessee.
- The corpus of the leased asset should exist at expiry of the lease, anything which cannot be used without consuming it cannot form the basis of *ijarah* contract.
- During period of *ijarah*, the lessor shall bear any loss caused by the factors beyond the control of the lessee.⁵⁴

c). Consideration/Rent:

- The rent must be determined at the beginning of the contract for the entire periods.
- The rent may take several forms including cash or benefit in kind.
- It is permissible that different amount of rent of fix for different rentals during the lease periods.
- The lessor cannot increase the rent actually without mutual consent.
- A part of rent can be received in advance and set against future rental payments.

⁵⁴Mansoori, *Op.Cit*, p. 231-235

d). Period/Termination:

- The period of the lease must be clearly specified
- Any change in term *ijarah* is permitted with only mutual consent
- The lease period will be effective with the delivery of the asset
- No party has the right to terminate the *ijarah* agreement prior to maturity without mutual consent
- The contract has been terminated if upon totally destruction of the leased asset or complete hindrance in intended use, unless if it caused by negligence or misconduct to the lessee then any losses that occurs as a result of destruction will be borne by the lessor, any payment of rent that it is not permissible for the lessor to charge the lessee any additional charges or penalty from part the income of the lessor as it has been defined *riba* or interest.

iii. Interest Free Loan (*Qard Hasan*)

The word *Qard* is derived from Arabic "*Qird*" which mean to cut. It is called *qard* as it cuts certain part of the lender's property by giving loan to the borrower, in Islamic financing, a loan, which under Islamic law is always free of profit.⁵⁵ *Qard hasan* entails loans that are free from any benefit or return to lender and it is more commonly referred to as interest-free loan. *Qard Hasan* is a kind of loan returned at the end of the agreed period without any interest or share in the profit or loss of the business.⁵⁶ Therefore, *Qard hasan* is a kind of gratuitous loan given to the poor and the needy people for a definite period without expecting the payment of interest or profit. The receiver of *qard hasan* is only required to repay the fixed amount of the loan.

This instrument will be contributed to a needy person or the poorest by helping their financial needs to live. It is equated to a loan to Allah (swt) Himself and the loan will be repaid with reward by Him multiplied. As the following verses from the holy Quran tells us the importance of this instrument:

- Who is he that will loan to Allah a *qard hasan* which He will multiply for him (the lender) many times and for him shall be a generous recompense. (57:11)

⁵⁵ See <http://www.qfinance.com/dictionary/qard>. (Accessed on 23/04/2014).

⁵⁶ M. Umer Chapra, "*Towards a just monetary system*", (UK: The Islamic Foundation, 1995), p. 68.

- If you loan to Allah a Qard Hasan, He will double it to your (credit) and He will grant you forgiveness: For Allah is most ready to appreciate (service). (64:17)

From the above verses it is clear that Islam provides very strong impulsive for the lender to help the poorest to meet their financial assistance by providing loans without expecting any return from them. Any such return expected or requested by the lender is forbidden *riba*. Islam prohibited all kinds of loan with interest (*riba*), as alternative of that it advocated the *Qard hasan* to enhance the brotherhood among Muslims. *Qard Hasan* financing product is such of *Tabarru* contract that is undertaken by assistance based. It is sort of agreement relating to not for-profit transaction.

This transaction is essentially not a business transaction to seek commercial profit. This is in accordance with the objectives of Islamic microfinance system that aim to carry on the people to the implementation of the two teachings of al-Quran, namely the principle of *al-iktinaz* avoidance, that is holding the money (fund), letting it idle and not efficiently managed in such transaction for the benefit of society as a whole. The *zakah* funds are to be distributed to beneficiaries that include the needy and poor in order to cover their basic daily necessities and to help them become financially strong thus getting them off from poverty. This model is benefited as with the availability of *zakah* funds as alternative financing sources for providing *Qard Hasan* for the vulnerable poor clients to have an opportunity to utilize the fund. As a means to expand their microenterprises thus enabling them in gaining more income and to help their state of welfare empowerment. The nature of *Qard Hasan* is merely for direct social aids and for safety nets program. This IMF product or microcredit does not burden the borrowers with the obligation to repay the loan with any excessive return. By the repayment of the loan, the *zakah* fund is automatically replenished and can be used to finance other recipients this is a sustainable Shariah-compliant form of financing provider for the poor.

Debt or loan system according to Islam:

- a. Islam allowed debt or loan and it must be returned
- b. However, lending lump sum of money in Islam its aim is to help not to seek profit
- c. All profits gained from such debt or loan is Riba

Characteristics of *Qard Hasan* fund:

- a. It is easily adjusted with respect to collateral
- b. Very simple documentary procedures
- c. Loans are usually in small size
- d. Quick approval procedures and disbursement
- e. There are no interest charges
- f. The capital contributor and borrowers can access the fund a lot easier because of its local base
- g. The fund managers, who are drawn from capital contributors, are fully accountable

Qardh hasan is becoming a social welfare strategy to help the fellow muslim brothers who are in desperate in financial needs. Thus, *qard hasan* enhances brotherhood among the Muslim ummah. The main objectives of *qardh hasan* are:

- a. To help the needy fellow Muslim ummah.
- b. To establish better relationship and the balance of life among the rich and poor.
- c. The mobilization of welfare and wealth among all people in the society.
- d. To perform a good deed that is planted in muslim ummah.
- e. To strengthen the national economy.
- f. To eradicate poverty and jobless from the society.
- g. To facilitate the poor to create new business ventures by using their skills, merits and experiences.

1.3 Historical background of BMTs in Indonesia

Bait al-Mal wa at-Tamwil (BMT; literally "House of Funds and Finance"; in other terms "Islamic cooperative") was the fist well-known in Indonesia Bina Insani Kamil BMT in 1992 in Jakarta. It is Islamic financial cooperative based not for profit as well as for profit financing. Thousand of members (usually from Muslim Ummah) join and conduct Islamic financial transactions in this institution, as an alternative path to conventional finance through IMFs which is interest based. The Islamic Scholars and Muslim activists are being very

effective media factors for the incredible development and growth of BMT, especially socialization through Islamic study among Muslim ummah. Currently, it has been subsequently spread out widely in the main city of Indonesia. They also set BMT in rural area, such as Tasikmalaya⁵⁷. However, from a legal standpoint, the establishment of BMTs is quite problematic because they have no formal linkage to the national monetary system and are neither controlled by the Bank of Indonesia nor by the Ministry of Cooperative. It had been incorporated under banking law No. 7 of 1992, stated that all the funds which are rotating among community in terms of savings and loans must be regulated under the provision of bank.

This is the sole problem for BMT at that time, however, to overcome this problem some of LPSM (Non Governmental Organization Development) came which was recognized as foundation of BMT. These LPSM include: P3UK (Assessment and Development Centre for Small Business) as early initiators, PINBUK (Centre of Incubator for small business), and Dompot Dhuafa (relief fund for poorest) as social Islamic institution. In the middle half of 1994, the development of BMT Bina Insani Kamil has been growing rapidly with a thousand members as well as a huge number of assets.

After 1995 PINBUK, an NGO, started promoting Islamic cooperatives. There were big jumps in numbers during the crisis years 1997/98, followed by a slowing-down, stagnation and decline.⁵⁸ The following table will describe the evolution of Islamic financial cooperatives particularly BMT:

Table 1: The evolution of Islamic cooperatives.

No	Phase	Period	Number of BMT
1	Initial growth	1990-1995	300
2	Rapid growth promoted by PINBUK	1996	700
		1997	1501
		6/1998	2470
3	Slowing-down of growth	2000	2,938

⁵⁷It is stated in the province of west java, Indonesia. The Regency is also known as a major religious centre in West Java, which has more than 800 pesantren (traditional Islamic boarding schools).

⁵⁸See, Hans Dieter Seibel with the collaboration of Wahyu Dwi Agung on *Islamic Microfinance in Indonesia*, Journal of Social Issues in Southeast Asia, Volume 23, Number1, April 2008.

4	Stagnation and decline	2001	3,037
		2003	2,856

Source: Hans Dieter Seibel

Islamic cooperatives suffer from the same benign regulatory neglect as conventional cooperatives. No such overall supervision and no systematic recording of either conventional or Islamic cooperatives (BMT); most BMT (83% according to a BI estimate) are not even incorporated with the Ministry of Cooperatives. After a period of rapid growth after 1995 when PINBUK assumed their promotion, they are now in decline; the majority of the 3000 BMT now are assumed to be dormant or technically bankrupt. PINBUK has no power to enforce reporting, much less so prudential regulation; the Ministry has the power, but does not use it, and may in fact be an inappropriate organization to do so. All general information provided in this report on cooperatives is therefore of questionable validity. In recent years, efforts have been made to improve the quality of cooperatives, reportedly with initial success in some areas like Central Java.⁵⁹

As mentioned before, BMT has set in rural area such as Tasikmalaya. It is playing a prominent role for the society as well as for the economic development in that area. It touched to bottom of the poor, provided their needs and helped out their burden as well. There are 15 units of BMT in Tasikmalaya which the asset as per unit estimated at Rp. 9,6 billion (\$ 9,6 million) and the smallest asset Rp. 46 million (\$ 4600).

⁵⁹*Ibid.*, p. 15

CHAPTER II

ISLAMIC MICROFINANCE INSTITUTION IN INDONESIA : Bait al-Mal wa at-Tamwil (analytical study of BMT in Tasikmalaya, West Java)

2.1 Introduction

The role of small and medium enterprises (SMEs), especially after the Asian monetary crisis in late 1990s, was considered as a safety valve for the national economic recovery both in enhancing economic growth as well as in reducing the unemployment rate. During 2000 – 2011, the value creation of SME sectors increased significantly while large enterprises decreased. SMEs also contributed about 87.9 % of the Indonesian Gross Domestic Product in 2011 compared to the contribution of large business enterprises. SME sectors could absorb about 98 million workers (99.4% of the labor force) and provide about 43.8% of commodity needs and national services.⁶⁰ The Bank of Indonesia also acknowledged that credit distributed to SMEs has minimum risk and has sounder and better performance compared to larger enterprises.⁶¹

In further development in Indonesia, driven by a sense of deep concern over the population of the poor (most of them are Muslims) which trapped by money lenders, and also to provide an alternative way for those people who wish to conduct and develop business but cannot strictly deal with conventional bank directly due to inadequate income and its relatively small and micro enterprises. Then, in 1992 born a small financial institution that operate and use combination system between the concept of Bait al-Mal and Bait at-Tamwil merely provided for the micro business sector. Conceptually BMT is an institution which contain two main activities:⁶²

- a. Collecting funds from various sources, such as: *zakat*,⁶³ *infaq*, *Sadaqah*, etc. And those are distributed to an authorized parties in terms of poverty alleviation.

⁶⁰The Bank of Indonesia, "Credit Crunch in Indonesia After the Crisis: The Facts, Causal Factors and Policy Implications," Internal discussion paper published by Department of Economy and Monetary Policy, the Bank of Indonesia (2001).

⁶¹*Ibid.*

⁶²Muhamad, "Lembaga-lembaga Keuangan Umat Kontemporer", Vol. I, (Yogyakarta : UII Press, 2000).

⁶³ - Zakat cannot be paid to a non-Muslim, unless this person belongs to category "Muallaf";

- Zakat money shall not be used to construct Mosque, Madrasah, Roads, general shelter homes;
- However, shelter homes for the poor can be built by zakat money giving full ownership to those eligible beneficiaries (indigent, poor, collector (*amil*), *muallaf*, *riqab*, insolvent (*gharim*), *shabilillah*, way farer);

- b. Productive activities with a purpose to create or gain additional income for the poor and fostering economic growth.

From this, it can be concluded that BMT covered two different activities, profit and non-profit based. BMT as a micro Shariah financial institution, besides generating funds from the society also plays as a financing institution, which lending money for consumptive or productive usage. Here, consumptive means not only *Murabahah* (margin markup) for consumptive goods but also for managing funds for *Infaq*, *Zakah* and *Shadaqah* and then distribute it in many forms for instance, educational scholarship, public facilities and others. While productive means lending capital to the small enterprises. All of operational activities conducted by BMT are supervised by Dewan Pengawas Syariah (Shariah Supervisory Board).

This research highlights the operation of BMT, followed by a discussion of the players in Islamic microfinance. Emphasis the potential role of Bait al-Mal wa at-Tamwil as a strategic community-based micro lending in java as the most increasing number reportedly, namely 65% in 2001 and 60% in 2003. Particularly, in Tasikmalaya, West Java, which contributes in poverty alleviation. The researcher will take BMT in Tasikmalaya as an example and representative of West Java, Indonesia. The researcher has collected data from 8 BMT institutions followed by interview with the beneficiaries. The profile of 14 BMT institutions in Tasikmalaya are given below:

-
- The rich who have enough to support themselves;
 - Zakat cannot be paid to: one's dependents whom he is responsible for supporting. These include the wife, the parents, grandparents (up to the eldest living grandparent), children, and grand children (down to the last born grand grandchild).

Table 2: The profile of BMTs in Tasikmalaya

CENTER FOR INCUBATOR FOR SMALL BUSINESS (PINBUK) TASIKMALAYA
PROFILE OF BMT MITRA
YEAR 2012

1 BMT KABUPATEN TASIKMALAYA								
NO	NAME OF BMT :	Address/Subdistrict	Telp	Manager	Legality	Total of Board	Total of supervise	Total of Manager
	Established				No. BH			
1	CINTAWANA	PP. Cintawana	081229700013	Farhan Fuadi M	Kapontren	4	2	4
	Agust 1996	Kec. Singaparna			9255/BH/PAD/KWK.10/11/1996			
2	NURUL BAHRI	Kp. Sabeluk	081308511550	Drs. Wawan Setawan	KBMT	3	2	4
	Des. 1995	Kec. Cipetujah			55/BH/PAD/KWK/16.15/2006			
3	DARUSSALAM	Komp. Pasar Cijawi Tsm	081323033589	Yanti Fajriah	810/BH/KWK.10/VI/1998	3		4
	1998							
4	AT TA'AWUJ	Des. Pakemban Kec. Cikaruan	085223721108	Tatang	88/BH/KDK.10.15/XII/1998	4	3	5
5	AL IDRISYYAH	Jl. Raya Cijawi Km. 8 No. 79 Ciasayong	08122330257		7284/BH/PAD/KWK.10			
2 BMT KOTA TASIKMALAYA								
NO	NAME OF BMT :	address/Subdistrict	telp	Manager	Legality	Total of Board	Total of supervise	Total of Manager
	Established				No. BH			
1	AL NIDAYAH	Jl. Cibenti No. 68	081220704990	Iwan Gunawan	114/BH/KDK.10.15/II/1999	4	3	6
2	AL MUAWANAH	Jl. HZ. Murota No. 100	085121544274	Teguh Heri Widodo	55/PEND/KUR/ATV/2006			6
3	AM NAHL	Jl. Silwangi 24	08121429483	Ade Komaludin	82/BH/KDP/III/2002	3	3	4
4	WIRA MAHDIRI	Jl. Banjar No. 3	08122289900	Eris Nuraisyah	489/BH/PAD/KDK.10.15/IX/1999	3	3	4
5	AL ITTIBAD	Pasar induk Cikurubuk	08154680775	Anwar Sidik	224/BH/KWK.10/15/XII/1994	5	3	6
6	MITRA KITA	Jl. R. H. Juanda (Komp. Perkantoran) Kota	085353430353	Esin Tursini	518/Kep.104-Oraskep/UKM/2007	1	3	3
7	AL BINA	Jl. Cipedes I No.15. Cipedes Tam	081223000705	Dudung Durahman	518/Kep.159-Diakop. UKM/2006	3		3
8	MITRA MUAMALAT	Jl. Runtuah Sakir No. 9	08122290050	Yan Hardiana	518/Kep.177-Diakop. UMKM Perindag/2009	3		3
9	MIAS		02126247947	Anand				

(Source: The Center for Incubator for Small Business (PINBUK) Tasikmalaya 2014).

Tasikmalaya is a city in southeastern West Java, Indonesia. The population of the city (excluding the rest of the regency) was 635, 424 according to the 2010 census.⁶⁴ The city also is dubbed as “The city of a thousand Pesantrens (Madrasah)” for its great abundance of Islamic religious schools. So, it has a great potential for the development of Islamic microfinance as its society awareness in understanding of Islamic rulings. The majority of its society livelihoods mostly are engaged in trade, industry, services, and agriculture. Beside that, they are dealing with small enterprises, therefore, the emergence of BMT as Islamic microfinance institution takes a fresh breeze for the poor and vulnerable society to enhance and strengthen their economy as well as to meet their needs. According to the Department of Industry and Trade in 2013, Tasikmalaya is the largest city in east-priangan, where almost 70% of the business center, center of trade and industrial center located in the city. Its economic growth has been increasing from year to year, it can be seen from the table below that describes the development of potential industry of Tasikmalaya from 2009 to 2012.

⁶⁴See <http://en.wikipedia.org/wiki/Tasikmalaya>. (Accessed on 22/04/2014).

Table 3: The Development of Potential Industry of Tasikmalaya

No	POTENTIAL	YEAR	INDUSTRIAL COMMODITY		TOTAL
			SUPERIAL PRODUCTS	NON SUPERIAL PRODUCTS	
1	BUSINESS UNIT (Unit Usaha)	2009	2.648	389	3.037
		2010	2.709	420	3.129
		2011	2.772	451	3.223
		2012	2.825	499	3.324
2	INVESTMENT VALUE (Rp. 000)	2009	336.498.282	102.703.693	439.201.975
		2010	351.923.547	107.337.583	459.261.130
		2011	370.343.547	115.651.083	485.994.630
		2012	390.015.547	126.499.083	516.514.630
3	VALUE OF PRODUCTS/YEAR (Rp. 000)	2009	1.781.914.712	573.628.642	2.355.543.354
		2010	1.903.155.707	613.353.754	2.516.509.461
		2011	2.002.861.515	645.318.054	2.648.179.569
		2012	2.113.499.515	768.836.970	2.882.336.485

(Source: Department of Industry and Trade 2014).

From the above table it can be explained that the development of potential industry of Tasikmalaya from year to year has been growing rapidly and effects on its economic growth. This development have impacted positively, one of them is employment absorption that has spread out widely, so that the welfare of society increased. A large number of business units in Tasikmalaya, particularly, SMEs is indicated that the city has a high potential and entrepreneurial spirit. However, if a high potential is not supported by a strong capital then it will not develop optimally. So, the existence of BMT in Tasikmalaya is indispensable for society, particularly, for SMEs and it can be used as a solution of the capital issue, in addition to the bank or BPR (Rural Banks). The development of BMT in Tasikmalaya was considered quite good, it can be seen from the rapid number of BMT's growth and its assets can bear down the assets of BPR since the BMT is under PINBUK regulation.

2.2 Basic Principles of BMTs

BMT was established by a community-based *Salaam* (peace), that is full of safety, peace and welfare. The basis principles of BMTs are mentioned in following:

1. *Ihsan* (the best quality of work), *thayyiban* (precious and valuable), *ahsanu 'amala* (satisfying all parties), and conformity with the values of *salaam*: peacefulness, salvation and prosperity;
2. *Barakah*, means beneficial, fare well, transparency, power reinforcement, and heavenly responsible to rely on the prosperity of society;
3. Spiritual communication;
4. Democratic, participative, inclusive;
5. Social justice, gender equivalence, indiscriminatively.

Functionally, this institution plays a role in following respects namely:

- To assist *bait at-tamwil* in providing cash for non-commercial funding allocation, *Qard Hasan*.⁶⁵
- Providing reserve fund in case of the inability of the customers to make payment due to bankruptcy which holds the status as *Gharim*.⁶⁶
- Playing a role in improving the social welfare.

According to its name and meaning, BMTs can play as financial intermediary by generating funds from those people who have maximum funds (surplus funds) by means of the function of saving and definite deposits also reallocate it to the people who are in desperate needs of financial aid (deficit funds) through many sectors of business activities in small or medium scale, or allocate it through savings and loans, also serve as financial institution with non-profit based, and distribute funds in respect of ZIS (*zakah, infaq, sadaqah*).

⁶⁵The financing which is provided by BMTs to customers without charges of profit shares or any other profits for customers.

⁶⁶According to the *Fiqh*, *gharim* is the person who is unable to pay debt and feed his family.

Operational system of BMT

Bait al-Mal wa at-Tamwil operates on the basis of Islamic law, so that all operations in such activities and products are offered in the form of Islamic microfinance services which refers to the concept of Islamic banking. There are three principles of IMF offered by BMT as operational product realization, namely:

a. Principle of Profit sharing

This principle is a system that includes procedures of profit sharing between the owner of fund (*sahibul maal*) with fund managers (*mudharib*). This sharing may occur between the BMT's members/partners. The form of products based on this principle is *Mudharabah* and *Musharakah*. In the concept of profit sharing, the portion of ratio of the profit should not be equal monthly, but for the purpose of efficiency, then the ratio substantially determined in each contract, especially for financing products.

b. Principles of sale with profit margin (Mark Up)

This principle is sale procedures, which its implementation is to appoint a member as an authorized agent to purchase goods on behalf of BMT. Then, BMT acts as the vendor who sells goods to their members or partners with fixed price plus profit (Margin/Mark up). The product of this form is based on *Murabahah*. Actually, BMT has not a certain rule in determining rate of mark-up as well as large mark-up set. All depends on the situation and specific condition in BMT itself as well as in the prevalence of market. It is necessary to have capabilities in respect of good analysis to determine the fluctuations of market price. So that, in the term of determination of mark-up, the fairness between customers and BMT would be achieved. There are several factors that can be considered in determining mark-up in BMT:

- Type of items to be sold
- BMT operational costs
- The cost of risk reduction
- Expected benefits
- Financing duration

c. Principles of Non-Profit

This principle suggests virtuous financing which is more sociable and not profit oriented. It is concessional loans for under capitalized small business. Members do not have to share profits to BMT, but they only pay the real costs incurred on transaction. This form is called *Qard Hasan*.

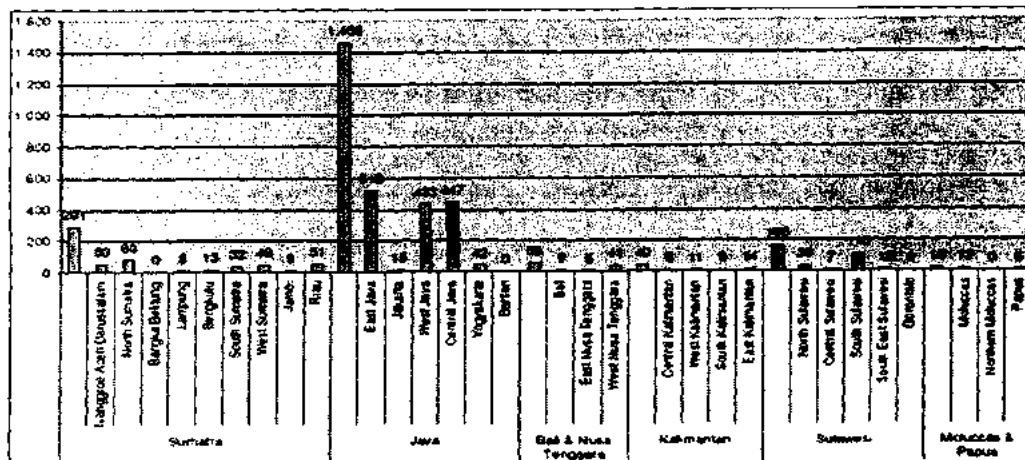
2.3 Members and Share capital of BMTs

BMT's members consist of:⁶⁷

- Founding members i.e. the members who pay primary savings, obligatory deposits, and others particular obligatory deposits with minimum 4% of the amount of BMT's capital.
- Ordinary members, i.e. the members who pay primary and obligatory deposits.
- Prospective members, i.e. those who utilize the services of BMT but have not paid the primary and compulsory savings.
- Members of honor i.e. the members who have concerned to participate in enhancing BMT's activities on both morally and materially, but cannot participate fully as a member of BMT.

The following figure is the distribution of BMT in Indonesia:

Figure 5: Distribution of BMT in Indonesia



(Source: Centre for Incubator for Small Business – PINBUK, 2005).

⁶⁷Heri sudarsono, "Bank and Islamic microfinance: description and illustration", (Yogyakarta: Ekonosia, 4th edition, 2007).

The share capital of BMT consists of:⁶⁸

- a. Basic contribution which is determined an equal amount of all members.
- b. Special basic contribution, i.e. basic contribution which is specifically targeted to get some initial capital in order to allow BMT to make and start its preparations. The amount can be variable for each members. In the term of the establishment of BMT, the founders agreed that within 4 (four) months from the agreed minimum amount of capital it can be raised up to Rp. 75 million for main city. The minimum capital for province is Rp. 50 million, the minimum capital for district area is Rp. 30 million and minimum capital for rural area is Rp. 10 million.

The proceedings of BMT:

1. The defrayal and micro-enterprise is conducted by applying profit-sharing system in accordance with the agreed contract.
2. The amount of this profit-sharing system is used by managers for paying manager's salary and BMT operational activities.
3. BMT can generate funds from commercial deposit products, it also can perform as *Bait al-mal* by generating funds from *zakah* and *waqf* (endowment).
4. BMT can open up business unit to fulfill the needs of members, if necessary.

Theory of BMT's financial funds

The BMT's financial funds mean a lump sum of money which is owned and controlled by BMT in its operations. BMT's funds consist of:

1. The first party's fund is a fund derived from the owners or members in the form of obligatory deposit capital and the value of BMT's effort.
2. The second party's fund is a fund derived from the market capital.
3. The third party's fund is a fund derived from BMT's raising fund such as savings, and deposit certificate.

⁶⁸Heri sudarsono, *Ibid.*, p. 27

BMT's fund has a function, namely:

- As a source of funding of operational costs
- Source of fund for primary and secondary investment
- As a buffer and absorbing the loss of BMT
- As a measure of BMT's size
- To attract people who have an excess fund in order to save it in BMT
- To enlarge public solidarity against BMT
- To increase the competitiveness of the BMT
- To facilitate an easy withdrawal and increasing human resources
- To expand branch offices.
- As a tool to manage the risk of the fault.

The emergence and development of BMT in Tasikmalaya significantly has reached good average, it can be seen from its assets as per unit. For financing, The chairman of PINBUK highlights that *Murabahah* is relatively dominant product. It is not only for consumptive financing but also for working capital financing. BMTs are very close to the community and highly support the micro economic actors so clearly.⁶⁹

According to the center for incubator for small business (PINBUK), that the current number of BMT more than 3000 in the country. While the number of Islamic Microfinance Institutions which is called BMT in Tasikmalaya, Indonesia has reached 50 BMTs. There are only 14 BMT which has reported their performance to PINBUK Tasikmalaya regularly in 2012. According to PINBUK Tasikmalaya regarding the asset of BMTs as per December 2012 has been reported that reached Rp. 24.198.434.659 (\$ 2.3 million). The detail report is mentioned below:

⁶⁹Anep Paoji, "the development of BMT in Tasikmalaya", (Bandung bisnis, april 27, 2012). See, <http://bandung.bisnis.com/read/20120427/5/176249/perkembangan-bmt-di-tasik-bisa-saingi-bprs>. (Accessed on June 14, 2014).

Table 4: BMT's financial report

KBMT MITRA FINANCIAL PINBUK TASIKMALAYA

Per December 2012

NO	NAME OF KBMT	BASIC DEPOSIT	OBLIGATORY DEPOSIT	DEPOSIT	ASSET	FINANCING	CAPITAL
		(Rp.)	(Rp.)	(Rp.)	(Rp.)	(Rp.)	(Rp.)
1	Al Hidayah	445.798.140	43.522.380	8.179.559.005	9.610.279.497	6.906.776.450	501.812.050
2	Al Muawanah	3.814.000	1.107.000	314.622.748	596.478.295	490.659.898	110.265.249
3	An Nahl	2.100.000	2.520.000	624.481.774	747.981.774	474.270.451	243.658.920
4	Wira Mandiri	13.100.000	16.505.000	1.323.075.100	1.464.684.150	1.088.906.950	138.983.350
5	Al Muttaqin	69.900.359	10.197.346	99.762.480	1.103.336.506	1.075.978.674	136.314.577
6	Al itthead	24.520.000	13.503.000	2.928.407.153	3.261.793.603	2.114.076.950	321.670.939
7	Mitra Kita	20.470.000	7.670.000	7.699.800	46.408.750	29.849.750	37.158.000
8	Al Bina	2.200.000	12.560.362	268.058.071	343.557.274	270.798.100	75.499.203
9	Mitra Muamalat	54.500.000	7.225.000	-	87.273.437	65.710.434	72.428.854
10	Nurul Bahri	30.630.000	308.224.590	5.360.108.905	4.090.905.434	3.140.409.164	722.037.186
11	Darussalam	3.295.000	3.111.000	70.000	320.973.047	124.683.783	144.007.247
12	Cintawana	5.690.000	21.843.715	228.269.187	720.756.536	577.228.657	255.802.902
13	At Ta'awun	46.506.000	295.986.120	1.439.408.718	1.804.006.356	-	1.657.674.466
Total		722.523.499	743.975.513	20.773.522.941	24.198.434.659	16.359.349.261	4.417.312.943

(Source is taken from PINBUK Tasikmalaya 2014).

2.4 The legal and regulatory context for BMTs

Since the issuance of Law No. 10 of 1998 to Legal Change No. 7/1992⁷⁰ on Banking issue that is: *"The policy of this regulation meant that in order to increase the role of national correspondence banks in accordance with their functions and the principle of cooperative, small and middle level enterprise, as for the society a whole in financing and distribution of*

⁷⁰ See, http://id.wikisource.org/wiki/Undang-Undang_Republik_Indonesia_Nomor_10_Tahun_1998. Taken from <http://www.mahkamahkonstitusi.go.id/>.

public funds without any discrimination" and fatwa prohibition of riba by the Indonesia Ulama Committe (MUI) in 2003 is stated that the Shariah Finance Institution (LKS) such as Shariah Banking, Shariah Pawn Shop (pegadaian Syariah), Takaful (Insurance Shariah), Bait al-Mal wa at-Tamwil or Islamic cooperative become well-known among upper and middle levels of society. The regulations for the BMT sector involve a more complex arrangement as described below:

- From an institutional perspective, the establishment of a BMT is based on a Letter of the Minister of Home Affairs No. 538/PKK/IV/1997 issued on 14 April 1997, concerning the Legal Status of Shariah Financial Institutions (Status Badan Hukum untuk Lembaga Keuangan Syariah).
- Norms for regulating membership of BMTs are regulated by Islamic Law under KUHD (Kitab Undang-undang Hukum Dagang).
- Arrangements for initial capital funds and members' savings are regulated by Law No. 25 1992 on Cooperatives.
- The Bait Al-mal (house of treasury) function is controlled by Law UU No 38/1999 on Management of *Zakah*.

The Ministry of Cooperatives intends to accommodate BMTs under its jurisdiction as cooperatives. For this, the Deputy Minister of Cooperatives and SMEs, Marsidi Rahardjo, has proposed an amendment of Law No.25 1992 on Cooperatives to clearly incorporate BMTs within the existing Law:⁷¹

- The Department of Finance is considering special regulations for micro-financing services which would apply to BMTs. This would mean BMTs were to be viewed in the same manner as any other microfinance institution.
- The BMT sector itself is determined to seek a law on BMTs which reflects their multiple functions as both microfinance and social institutions.

⁷¹Prof. DR. Ir. M. Amin Aziz, "The procedure of BMT establishment", (Jakarta: pkes publishing, 2008), p. 50.

Assessing Cooperative Corporation for BMT

The desire of Islamic economic implementation in Indonesia arises from the realization that Islam is a comprehensive and universal teachings in which contain of all human being aspect of life including economics. Beside the failure of socialist and capitalist economic system which the monetary crisis occurred in 1997 have an impact on the stability of economy over the world. The crisis that led to the instability of economy makes every country busy by seeking the solution in order to be able to survive. In Indonesia, the impact of global crisis affected almost to all sectors of life, especially in economic sector, it can be seen from the instability of exchange rate, strong wave of layoffs increasingly, even the number of micro-economic enterprises fell into bankruptcy. In these circumstances, the Islamic economic system is used as a solution to overcome crisis.

BMT has been growing rapidly which was established by gradual process of legality of law; the first was started as KSM (Community Based Organizations) it is Non-governmental organizations. If it has reached the value of certain assets it should follow cooperative legal entity. This policy has been made because the legality of business in Indonesia is well-recognized only three: Limited Liability Company (PT), State-Owned Enterprises (SOEs) or Government-owned Corporation (GOC), and Cooperative. So that, the employment guidelines, health assessment, and regulations of BMT refer to cooperative department.

Profit Distribution System in BMT

- In the term of net income distribution, BMTs operate accrual basis system and cash basis
- The distribution system is being agreed in the beginning of contract
- If the distribution of profit is shared by revenue sharing for the customer's right, then the determination of profit sharing is shared by calculating the total principal operating revenues (sale, profit sharing, hiring) after deducting the expenses of BMT
- BMT is not always (sometimes) informing the calculation of profit distribution to the customers.

2.5 BMT Products and Services in Tasikmalaya

Table 5: The products of BMTs Tasikmalaya

NAME OF BMT	PRODUCTS and SERVICES						
	Musharakah	Mudharabah	Ijarah	Qard Hasan	Murabahah	Hawalah	Kafalah
Al-Hidayah	x	✓	x	x	✓	x	x
An-Nahl	✓	x	x	✓	✓	x	x
Wira Mandiri	x	✓	✓	x	✓	✓	✓
Mitra Kita	x	✓	x	x	✓	x	x
Mitra Muamalat	x	✓	x	x	✓	x	x
Al-Bina	✓	✓	x	✓	✓	x	x
Al-Muawanah	✓	✓	x	x	✓	x	x
Al-Ittihad	✓	✓	x	x	✓	x	x

(source is taken from questionnaire)

2.5.1 Financing Product

In the form of financing activities, BMT takes a concept of profit sharing as a fulfillment of financing needs (equity financing) and investment based on rewards through sale as a fulfillment of mechanism to financing needs (debt financing).⁷²

2.5.1.1 Sale Financing/debt financing

Debt financing is conducted through sale contract. Definition of *ba'i* covers a wide range of goods and services exchange contracts on specific quantities.⁷³ The goods or

⁷² Zainul Arifin, "Understanding Islamic banking, scope, opportunity, challenge, and Prospect", (Jakarta: Al-fabet, 1999), p. 100.

⁷³ *Ibid.*, p. 102

services can be delivered by cash payment or deferred payment. The following are the forms of debt financing/sale financing are:

a. Murabahah Financing

BMT buys commodities and then sells to the customers at fixed price plus benefits. BMT should honestly tell the cost of commodities following by the operational expenses, so that the customers can pay the agreed price of the commodities within a specified period⁷⁴. *Murabahah* financing is a financing of such bridging fund which is required by customers to purchase a good or service or any other needs with one condition that the fund should be returned by installment or cash in the definite time. This product is the famous instrument in Islamic Microfinance, all the BMTs operate this product. **BMT Al-ittihad, BMT Mandiri, BMT Mitra Kita, BMT Mitra Muamalat** earned the profit margins from the bargaining transaction between the buyer and seller where the margin amount is not determined. While, **BMT Al-hidayah** and **BMT An-Nahl** determined the profit margin in accordance with their management policies. The process of flow of *murabahah* is given below:

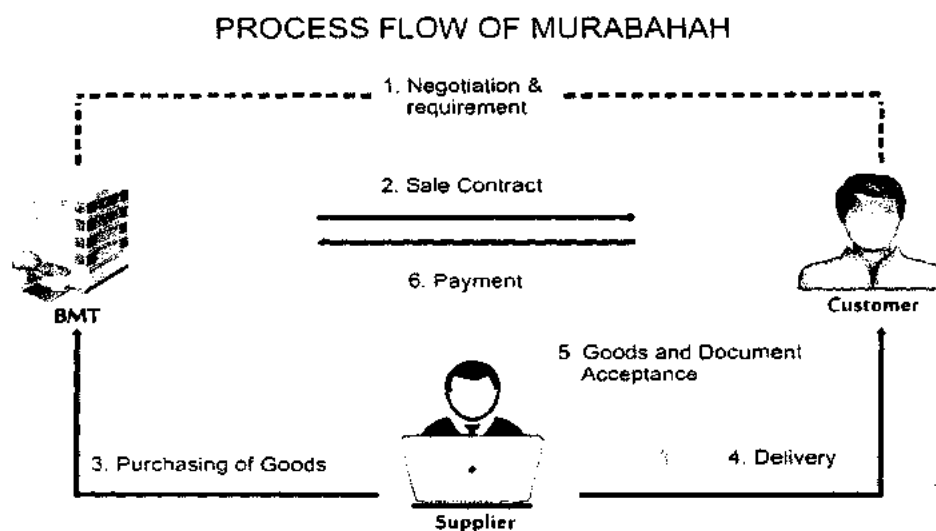


Figure 6. The process flow of Murabahah in BMT

⁷⁴Fatwa DSN-MUI No. 04/DSN-MUI/IV/2000 on murabahah (<http://www.bapepam.go.id/syariah/fatwa/index.html>).

Murabahah Financing Mechanism in BMT Tasikmalaya are as follows:⁷⁵

1. The average administrative expense of *murabahah* financing is around 1% - 3%.
2. The BMTs do not obligate their customers to pay '*Urbun*. While in BMT Al-Hidayah and BMT Mitra Kita, the payment of '*urbun* is an obligatory. The minimum amount of '*urbun* is 40% for BMT Al-Hidayah and 20 % for BMT Mitra Kita.
3. '*Urbun* will returnable if the member or the customer cancels the contract of *murabahah*.
4. If any members fall into the debt, although they are able to pay, the BMT will impose sanction such as low attention and fine, if they neglect its sanction. The fine is allocated for ZIS (*Zakah, Infaq, Shadaqah*), while BMT An-Nahl allocates it for *Qard Hasan's* fund.
5. The amount of *Murabahah* financing is Rp. 1.000.000,- up to Rp. 5.000.000,- while BMT Mandiri is Rp. 500.000,- up to Rp. 1.000.000,-
6. The average duration of *murabahah* financing is 6 – 12 months, for BMT Al-hidayah is 12 – 36 months, and for BMT Mitra Kita is 3 – 6 months.
7. BMT (as a seller) bears the risk if the value of the purchased goods reduced before it has been delivered to the buyer. BMT will observe where the mistake is.
8. The average type of *murabahah* financing items are the following:
 - a. Moveable property such as vehicles
 - b. Electronic items
 - c. Houses
 - d. Family needs such as education, treatment etc.
 - e. Working capital

Opinions of Indonesian Council of Ulama and AAOIFI (Shariah Standards)

1. Based on Fatwa of National Shariah board – Indonesian council of Ulama No: 04/DSN-MUI/IV/2000 on *murabahah* transaction is given below:
 - Terms of *murabahah* in Islamic bank:

⁷⁵An interview with the managers of BMT and its members based on questionnaire

- Bank and customer should conduct *murabahah* contract and it should be free from *riba*
- The commodity must be *halal*
- Bank purchases goods which is required by customers on behalf of the bank
- The bank sells the goods to the customers (buyer) with the fixed price plus profit. In this regard, the bank shall notify the cost of goods honestly to the customer following by the required fee.
- Customer pays the agreed price of goods at the agreed period of time.
- To prevent misconduct or frustration of contract, the bank may conduct a special agreement with customers.
- Terms of *murabahah* for the customers:
 - Customers apply for application and promise to purchase goods
 - If the bank receives the application, it is required for the bank to purchase the ordered asset legally from the seller.
 - Bank offers these assets to customers and they are obligated to receive (buy) it in accordance with the agreed promise, because it is legally binding.
 - In this sale contract, the bank is allowed to demand the customer to pay an advance payment.
 - In case of cancellation of sale, the bank may take advance payment to cover the loss.
 - If the amount of advance payment less than the loss, the bank shall bear the loss and the bank can reclaim the rest of losses to customer.
 - If *'Urbun* is being used as an alternative advance payment, then:
 - If the customers decide to purchase the goods they have to pay the rest of its price.
 - If the customer cancels to purchase the goods, the advance belong to the bank as a result of such cancellation, in case of insufficient advance, the customer has to pay off the deficiency.
- Guarantees in *Murabahah*:
 - Guarantees in *Murabahah* is allowed, in order to make customer strictly serious with his order.

- Bank may require the customer to provide a collateral which is held by the bank.
2. Accounting and Auditing Organization for Islamic Financial Institutions (Shariah Standards) on *murabahah*.
- a. Procedures prior to the contract of *Murabahah*:
- It is permissible for the institution to purchase the item only in response to its customer's wish and application, as long as this practice is compatible with the Shari'a precepts for the contract of sale.
 - It is permissible for the customer to request the institution to purchase the item from a particular source of supply.
 - The customer's wish to acquire the item does not constitute a promise or commitment except when it has been expressed in due form.
 - The customer may obtain statement of prices from the supplier whether they are addressed to the customer by name, or with no reference to any named customer. In the latter case, the statement is considered as an invitation to negotiate, and not as an offer of sale.
- b. The position of the institution in respect to the application of the customer for *murabahah* to the purchase orderer:
- When there is acceptance by the customer of an offer from the supplier that is either addressed to him personally, or that has no addressee, then it is not permissible for the institution to carry out *murabahah* to the purchase orderer.
 - It is essential to exclude any prior contractual relationship between the customer who is the purchase orderer and the original supplier of the item ordered, if any, regarding the supply of the item.
 - The institution must ensure that the party from whom the item is bought is a third party, and not the customer or his agent.
 - It is not permitted to carry out a *Murabahah* on deferred payment terms where the asset involved is gold or silver or currencies.
- c. Commissions and expenses:
- It is not permissible for the institution to receive a commitment fee from the customer.

- It is not permissible for the institution to receive a fee for providing a credit facility
 - The expenses of preparing the documents of the contract between the institutions and the customer are to be divided between the two parties (the institution and the customer), provided they do not agree that the expenses are to be born by one of the parties, and provided those expenses fair, that is they reflect the amount of work involved, so that they do not implicitly include a commitment fee or a facility fee.
 - It is permissible for the institution to take a fee for a feasibility study that is undertaken, if the study is based on the request by the customer and is for his benefit, and he agreed to pay the fee from the outset.
- d. Guarantees related to the commencement of the transaction
- It is permissible for the institution to obtain from the customer (the purchase orderer) a guarantee regarding the good performance by the supplier of his contractual obligations towards the institution in his personal capacity and not in his capacity as purchase orderer or in his capacity as an agent of the institution.
 - It is not permitted to impose on a customer who is the purchase orderer a guarantee regarding hazards that may affect the item such as damage and destruction during a period of shipment or storage.
 - It is permissible for the institution, in case of a binding promise by the customer, to take a sum of money as *hamish jiddiyyah* (i.e. a security deposit). This is to be paid by the customer at the request of the institution, both as an indication of the financial capacity of the customer and to ensure the compensation of any damage to the institution arising from a breach by the customer of his binding promise.
 - In the case of the customer's breach of his binding promise, the institution is not permitted to retain *hamish jiddiyyah* as such.
 - When the customer has fulfilled his promise and executed the contract of *murabahah* to the purchase orderer, the institution must refund *hamish jiddiyyah* to the customer. The institution is not entitled to use any amount of *Hamish jiddiyyah* except in the case of breach of promise.

- It is permissible for the institution to take *urbon* (earnest money) after concluding the *murabahah* sale with the customer. It is preferable that the institution return to the customer the amount that remains after deducting the actual damage incurred from the *urbon* as a result of the breach, namely the difference between the cost of the item to the institution and its selling price to a third party.

b. Ijarah Financing

Ijarah is a contract of transfer of right of goods or services within a particular time through wage or rent unfollowed by transfer of ownership of goods. The form of *ijarah* has been discussed in chapter one, therefore the researcher will highlight its terms and conditions in the light of fatwa of National Shariah Board – Indonesian Council of Ulama. Moreover, the terms of *ijarah* financing in BMT will be discussed. The objective of such financing will not apart from the establishment of BMT's mission. Then main objectives of such financing namely:

- **Assisting customer's business**
That is to assist customer's business who is requiring funds, either for investment or for the capital of business. With these funds the debtor is able to develop and expand his business.
- **Assisting the government**
The more number of financing which are provided by BMT the better for governmental development. It is considered by many financial institutions grow in the various sectors.

In addition to the above objectives, following are the benefits of financing:

- a. **To enhance the efficiency of money.**
With this financing facility, it can improve the efficiency of money. In other words, if the money is not explored it will produce nothing useful.
- b. **To improve the circulation and traffic money.**

In this case, the money which is given or distributed will be circulated from one region to other areas.

- c. To enhance the efficiency of goods.

The financing, which has been provided by BMT will be used by a debtor for processing the useless items into useful items.

- d. To enhance the circulation of goods.

Financing may also increase or accelerate the flow of goods from one region to another, so that the number of outstanding items from one area to another can also be increased or the financing can increase the number of circulating items.

- e. As a tool of the stability of economy.

By providing such financing, the people can achieve their daily necessity and it will cover their whole needs.

- f. To heighten the desire of business

The people would able to increase their business desire, especially for the customers who are in mediocre capital.

- g. To increase the distribution of income.

The more funds are distributed the better income would be achieved, especially in the terms of raising revenue.

- h. To improve international relationship.

In the terms of international loan it will able to increase the mutual needs among the recipients of finance with the financier.

In this regard, only BMT Wira Mandiri applies the *ijarah* financing. While, the other BMTs are not ready yet to operate it due to they have several limitations. BMT Wira Mandiri was established in 1997 as a self-help group (KSM). Later in the year it changed its status to BMT and it was incorporated as a cooperative of employees of Yayasan Wira Mandiri (YWM), a foundation. In 1999 it was incorporated as Koperasi BMT (KBMT). Its founding organization, which has been established for promoting Islamic education, it is now dormant but living on in BMT. The following figure is the process flow of *Ijarah*:

PROCESS FLOW OF IJARAH

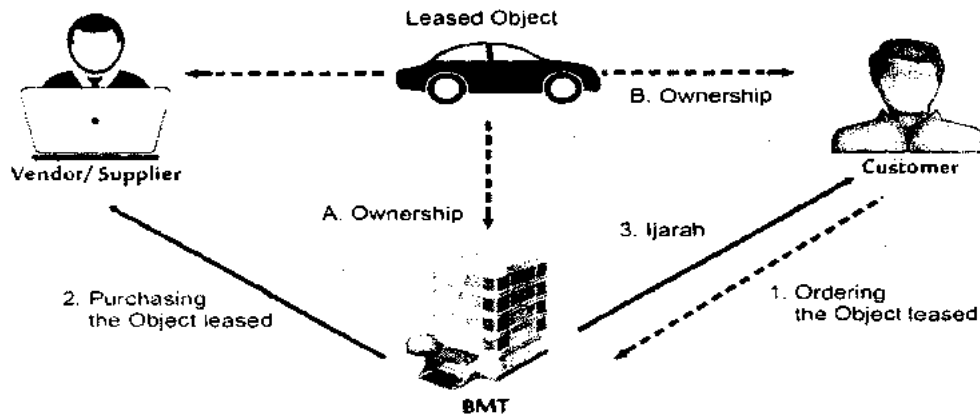


Figure 7: The process flow of ijarah in BMT

Opinions of Indonesian Council of Ulama and AAOIFI (Shariah Standards)

1. Based on Fatwa of National Shariah board – Indonesian Council of Ulama No: 09/DSN-MUI/IV/2000 about *ijarah* financing are mentioned below:
 - Terms of the object of *ijarah*
 - The object of *ijarah* is the benefit of the goods or services.
 - The benefits of goods or services must be assessed and it can be implemented in the contract.
 - The benefits of the goods or services must be *halal*.
 - The ability to meet the needs and benefits must be real and appropriate with Shariah.
 - The benefits must be specifically identified in such a way to eliminate *jahalah* (ignorance) which will lead to a dispute.
 - The specification of benefits must be clearly stated, including the period of time. It can also be identified by the specification or physical identification.
 - Hire or fee is something that is promised and paid by the customers to Islamic financial institutions as the benefit of payment. Something that

is enable to be used as a price in the sale contract, also enable to be used as *ijarah*.

- The Flexibility in determining of such a rent or fee can be realized in the term of time, place and distance.
- The obligations of Islamic financial institutions and customers in *ijarah* financing:
 - a. The obligations of Islamic financial institutions as the provider of the benefit of goods or services:
 - 1. To provide the leased goods or services.
 - 2. To bear the item cost maintenance.
 - 3. To assure the defect in the leased goods, if any.
 - b. The obligations of customer as a beneficiary of goods or services:
 - 1. To make *ijarah* payment or fee and responsible for maintaining the integrity of the goods and use them according to the contract.
 - 2. To bear the item cost maintenance that is light in weight (not material).
 - 3. If the leased item is damage, neither from the violation of allowed usage nor from the negligence in respect of the beneficiaries, he is not responsible for such damage.
- If either party does not fulfill his obligation, or if there is disagreement between the two parties, and the agreement cannot be solved by deliberation, then the dispute settlement can be referred to the Shariah arbitration board.

2. Accounting and Auditing Organization for Islamic Financial Institutions (Shariah Standards) on *ijarah*.

- a. Promise to lease (an asset)
 - In principle, an *ijarah* contract is executed for an asset owned by the lessor. However, it is for a customer to request an institution to acquire the asset or to acquire the usufruct of an existing asset which the customer wishes to take on lease.

- A master agreement may be drawn up covering a number of *ijarah* transactions between the institution and the customer, setting out the general terms and conditions of agreement between the two parties.
 - It is permissible for the institution to require the lease promissory (customer) to pay a sum of money to the institution to guarantee the customer's commitment to accepting a lease on the asset and subsequent obligations.
- b. Subject matter of *Ijarah*
- The leased asset must be capable of being used while preserving the asset, and the benefit from an *ijarah* must be lawful in Shariah.
 - The subject matter of *ijarah* may be a share in an undivided asset held in common with the lessee, whether the lessee is a partner with the lessor or not.
 - An *ijarah* contract may be executed for a house or chattel, even with a non-Muslim.
 - The lessee must use the leased asset in a suitable manner or in conformity with common practice and comply with conditions which are acceptable in Shariah.
 - The leased asset is the responsibility of the lessor throughout the duration of the *ijarah*, unless the lessee commits misconduct or negligence.
- c. Guarantee and treatment of *ijarah* receivables
- Permissible security, of all kinds, may be taken to secure the rental payments or as a security against misuse or negligence on the part of the lessee, such as a charge over assets, guarantees or an assignment of rights over assets of the lessee held by third parties.
 - The two parties may agree that the rental be paid instantly.
 - No increase in the rental due may be stipulated by the lessor in case of delay in payment by the lessee.
 - In case of foreclosure of the security provided by the lessee, the lessor may deduct from such amounts only what is due in respect of rental for previous periods, and not all rental instalments, including instalments which have not yet fallen due and in respect of periods for which the lessee has not had the benefit of the leased asset.

2.5.2 Equity Financing/Profit Sharing Financing

A. *Musharakah* Financing (Partnership)

Musharakah Financing is an agreement of partnership between two or more parties for a particular business, in which each party gives contribution of funds based on the agreement i.e. the benefits and risks are shared in accordance with the agreement.⁷⁶

From the above definition, it can be seen that the characteristic of agreement/*Musharakah* contract, namely the contribution of funds come from two sides (BMT and customers) and profit-sharing based on capital contribution. In *musharakah*, the ownership of two or more people are divided into a real assets. In the term of business management, the BMT is included or involved in the management process. The application of BMT in respect of *Musharakah* contract namely:

1. Project financing.

The customers and BMT are equally providing funds to finance projects. After the project is completed, the customers return the funds together for a mutual agreed outcome.

2. Venture capital.

In BMT it is allowed to invest in the company, *Musharakah* contract is applied in the scheme of venture capital. The investment is made for a specific period, and after that the BMT divested, either briefly or gradually.

In this regard, from 8 BMTs which has been examined, there are 4 BMTs operating the *Musharakah* financing. Namely:

1. BMT An-Nahl
2. Al-Bina
3. Al-Muawanah
4. Al-Ittihad

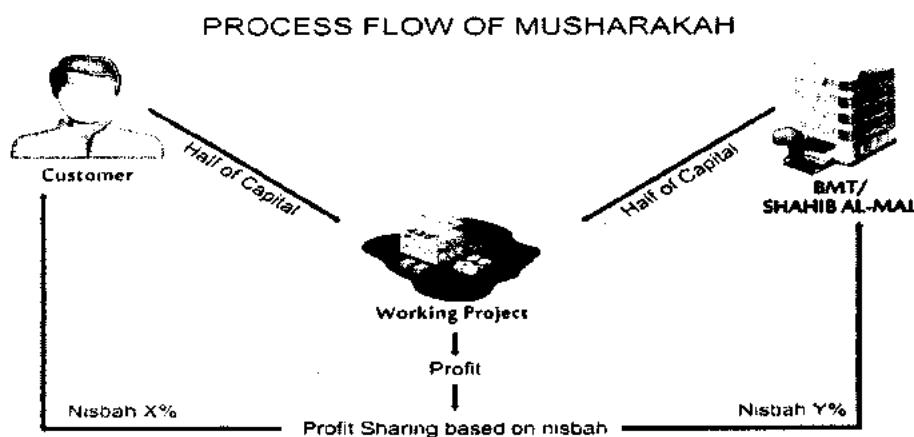
⁷⁶Fatwa of National Shariah Board – Indonesian council of Ulama, No. 08/DSN-MUI/IV/2000.

Based on the research of 4 BMTs, there are several regulations of *Musharakah* financing that can be concluded:

- a. BMT considers *Musharakah* financing to the partners as a capital (investment)
- b. BMT requires the period of business at least 3 years has been operated
- c. In this transaction, BMT requires the customer/partner to hand over the collateral
- d. BMT is merely becoming a supervisor and guide, neither in such management nor in such transactions.
- e. In case of loss due to negligence or misconduct of business manager, it will be borne jointly by BMT and business manager
- f. BMT determines the profit or loss from the report of *mudharib's* funds
- g. Installment or payment system of *musharakah* financing is being paid daily or monthly. Profit sharing is going to be shared at the end of contract
- h. The average period of *musharakah* financing is (3 – 12 months) and the average amount of *musharakah* financing is (Rp. 500.000,- to Rp. 5.000.000,-)
- i. The types of enterprises that are financed by *musharakah* pattern are:
 - Trade
 - Livestock
 - SMEs

Following the process flow of *musharakah* in BMT:

Figure 8: Process flow of *Musharakah* in BMT



Opinions of Indonesian Council of Ulama and AAOIFI (Shariah Standards)

1. Fatwa of National Shariah board – Indonesian Council of Ulama No: 08/DSN-MUI/IV/2000 about *Musharakah financing* are mentioned below:

➤ Terms and Conditions:

1. *Ijab* and *Qabul* statement must be declared by the parties to indicate their will to execute the contracts. In this regard, the rule of *ijab* and *qabul* is mentioned as follow:
 - a. *Ijab* and *Qabul* must explicitly indicate the purpose of the contract.
 - b. *Ijab* and *Qabul* should be made at the time of contract.
 - c. The contract shall be made by writing through correspondence, or by using modern communication method.
2. The parties must be competent in understanding the contract law and they must pay attention to the following matters:
 - a. Competent in giving or deserving the representation power.
 - b. Each partner must provide funds and jobs, and each partner carries out the work as representative.
 - c. Each partner has a right to regulate the *Musharakah* assets in normal business process.
 - d. Each partner gives an authority to another partners to manage the assets and everyone is considered to have authority to perform *Musharakah* activity with due regard to the desire of his partner without any negligence and willfully misconduct.
 - e. A partner is not allowed to disburse or invest a fund for his own benefit.
3. The object of contract (capital, job, profit and loss).
 - a. Capital
 - The capital should be given in cash, gold, silver or equal value. It may consist of trading assets, such as goods, property, and so on. If its form is such of asset, first it should be assessed by cash and is agreed upon by the partners.

- The parties shall not borrow, lend, donate, or present the capital of *Musharakah* to another parties, except on the basis of agreement.
- Principally, there is no guarantee in *Musharakah* financing, however, to avoid deviation, LKS (Islamic Financial Institution) can demand the guarantee.

b. Work:

- Participation of partners is the basis implementation of *Musharakah*; but, the similarity of working ratio is not a requirement. A partner may work more than other, in this case he may sue an extra profit.
- Every partner works in *Musharakah* contract on behalf of his personality and his partner representative. Each portion has to be specified in the contract.

c. Profit:

- The profit should be quantified clearly to avoid differences and disputes at the time of distribution of profit or termination of *Musharakah*.
- Every partner's profit should be distributed proportionately on the basis of entire profits and the amount is not specified by the partner in the beginning of contract.
- A partner may propose if the profit exceed a certain amount, the excess or percentage is given to him.
- Profit-sharing system must be stated clearly in the contract.

d. Loss:

- Losses should be shared among the partners proportionally according to their respective share capital.

4. Net-operating cost and Dispute:

- Net-operating cost is charged by their capital.
- If either party does not fulfill his obligation, or if there is disagreement between the two parties, and the agreement cannot be solved by deliberation, the dispute settlement can be referred to Shariah arbitration board.

2. Accounting and Auditing Organization for Islamic Financial Institutions (Shariah Standards) on *musharakah*.

a. Sharika contract

- A sharika contract can be concluded by agreement between the parties concerned on the basis of offer and acceptance.
- It is permissible for the institution to enter into a partnership contract with non-Muslim or conventional banks to carry out operations acceptable by Shariah unless it has become evident that the funds or items presented by these entities for the purpose of the partnership are from non-permissible sources.
- It is permissible for the institutions to include conventional banks as partners in a syndicated financing which operates on the basis of Shariah.
- It is permissible for the partners to amend at any point of time the terms of partnership contract.

b. The capital of Sharika

- In principle, the capital of sharika should be contributed in the form of monetary assets on which one can rely in order to determine the amount of the capital and to recognize profit or loss.
- If partners have contributed their partnership capital in different currencies, this currencies must be translated into the currency of the sharika at current exchange rate.
- The share of each partner in the capital should be determined.
- The funds of current accounts, although they are juristically classified as loans to the institutions.

c. Managing a sharika venture

- In principle, each partner is entitled to act in the interest of the partnership in the following transaction: spot or deferred sales; taking possession or custody of the partnership receivables; making payments or deposits and providing or receiving a pledge on behalf of the partnership.

- It is permissible for the partners to agree that the management of the partnership will be restricted to certain partners or to a single partners.
 - It is permissible for the partners to appoint a manager other than one of the partners and pay him a fixed remuneration that will be included in the expenses of the sharika.
 - It is not permitted, in a sharika contract, to specify a fixed remuneration for a partner who contributes in managing the sharika funds or provides some form of other services, such as accounting.
- d. Guarantees in a sharika contract
- All partners in a Sharika contract maintain the assets of the Sharika on a trust basis.
 - It is permissible for a partner in a sharika contract to stipulate that another partner provides a personal guarantee or a pledge to cover cases of misconduct, negligence or breach of contract.
 - A third party may provide a guarantee to make up a loss of capital of some or all partners.
- e. The outcome of Sharika investment (profit and loss)
- The sharika contract should incorporate a provision specifying the manner or sharing profits between the parties.
 - It is not permitted to defer the determination of the profit percentages due to each partner until the realization of profit.
 - In principle, the shares of profit must be in proportion to the percentage of each partner's contribution to the Sharika capital.

B. *Mudharabah* Financing (Trustee profit sharing).

Mudharabah financing is an agreement of contract between two joint ventures of parties where the first party (*shahib al-mal*) provides the entire capital, while the other become a manager and the profit will be shared in accordance with the agreement set forth in the contract.⁷⁷

⁷⁷Fatwa of National Shariah Board – Indonesian council of Ulama, No. 07/DSN-MUI/IV/2000.

From the above definition, it is worthy to note that BMT bears the entire capital, while the customer only has an expertise capital (but does not have a fund). The profits shall be shared according to the agreement, while losses entirely borne by the owner of capital (BMT) as long as for not due to negligence of the manager (*mudharib*). The application of *Mudharabah* financing in BMT institution namely:

1. Working capital financing, for instance working capital of trade and service.
2. Specific investment (*Mudharabah al-muqayyadah*), where the special funding sources with a special distribution and special requirement which has been decided by *shahibul maal*.

Mudharabah particularly applied in financing and funding products. In the term of funding, *mudharabah* applied in:⁷⁸

- a. Time deposit is the deposit which has a particular purpose, such as pilgrimage deposit (deposit of *hajj*), *Qurban* deposit, etc.
- b. Special deposit, where the fund that has been deposited by customer is provided only for specific business, such as only for *murabahah* or *ijarah*.

Following are the benefits of *mudharabah* for BMT:

- a. BMT will enjoy profit sharing improvement at the time of the increasing customer's profit
- b. The return of financing principal is adjusted by cash flow, so that it does not burden the customer
- c. BMT will be more selective and prudently to seek the *Halal* matter, safe, and profitable because the profit will be shared.
- d. The principal of *mudharabah/musharakah* is strictly different from interest (read: *riba*) where the conventional microfinance would charge the customers from the earned profit, although they suffered loss or economic crisis occurred.

⁷⁸ M. Syafi'i Antonio, "*Bank Syariah Dari Teori ke Praktik*", (Jakarta: Gema Insani press, 2001), P. 97.

The Risk of *Mudharabah*:

The risk occurs in *mudharabah* is relatively high, especially on its application in financing. Following are the risks:

1. Side streaming, the customer uses the fund improperly as mentioned in the contract
2. Negligent and willfully misconduct
3. Concealment of profits by dishonest customer

The mechanism of *mudharabah* in BMT Tasikmalaya:⁷⁹

- a. BMT considers *Mudharabah* financing as a debt, while BMT Al-hidayah considers it as capital (investment)
- b. In this transaction, BMT requires the customer to hand over the collateral, while BMT Wira Mandiri and Mitra Muamalat are not requiring the collateral
- c. In the term of loss due to negligence or misconduct of business manager, it is borne by business manager
- d. BMT determine profit or loss from the report of BMT's calculation, while BMT Al-hidayah determine it from the analysis of customer's business⁸⁰
- e. Installment or payment system of *Mudharabah* financing is being paid daily or monthly. While the profit is being shared at the end of contract
- f. The average period of *Mudharabah* financing:
 - BMT Mandiri and BMT Mitra Muamalat (3 – 12 months)
 - BMT Al-bina and BMT Al-Ittihad (6 – 12 months)
 - BMT Al-hidayah and BMT Al-muawwanah (12 – 36 months)
- g. The average amount of *Mudharabah* financing is above Rp. 5.000.000,- while BMT Mitra Kita is Rp. 500.000,- to Rp. 1.000.000,-
- h. The types of enterprises that are financed by *Mudharabah* pattern are:
 - Trade (30%)
 - Livestock (10%)

⁷⁹An interview with the managers of BMT and its members based on questionnaire

⁸⁰In this regard, the practice of *mudharabah* in BMT Tasikmalaya still not refers to the principle of shariah. The BMT does not report a fixed monthly profit transparency as commonly applicable in IMFs. So that, the BMT should report a fixed monthly profit to the customers in order to evade curiosity of them.

- SMEs (50%)
- Services (5%)

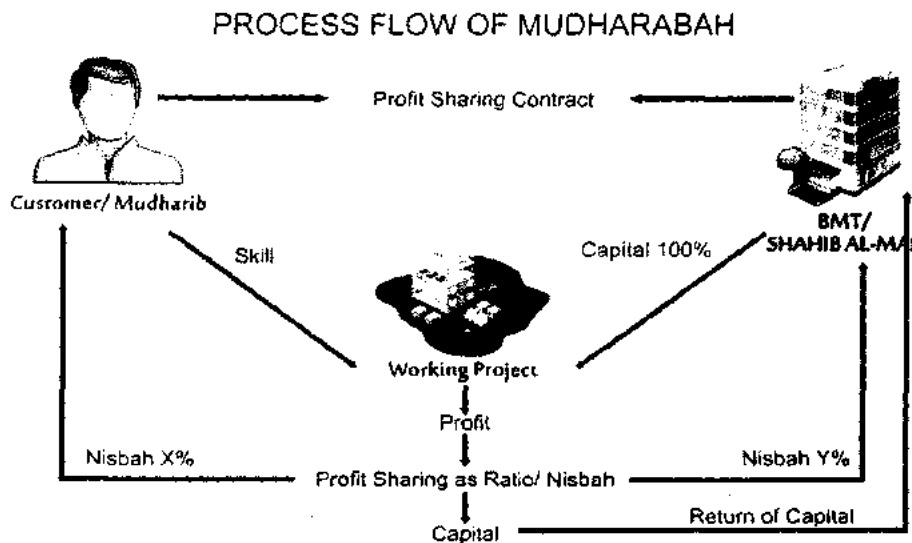


Figure 9: Process flow of Mudharabah in BMT

Opinions of Indonesian Council of Ulama and AAOIFI (Shariah Standards)

1. Fatwa of National Shariah board – Indonesian Council of Ulama on *Mudharabah* financing⁸¹ are mentioned below:

1. Terms of Financing:

- Mudharabah* is a financing provided by Shariah Financial Institution to the party for a productive business.
- In this financing, Shariah Financial Institution acts as *shahib al-mal* (the owner of funds) i.e. 100% of the capital, while the employer (client) acts as *mudharib* or business manager.
- Duration of business, refund procedure, and profit distribution is determined by the agreement of both parties (SFIs and entrepreneur).

⁸¹ DSN (National Shariah Board) No: 07/DSN-MUI/IV/2000.

- d. *Mudharib* may conduct a wide variety of businesses that have been mutually agreed and appropriate with the shariah rulings, and SFIs do not participate on company management or project, but it has a right to conduct training and supervision.
 - e. The amount of fund should be clearly stated on cash not debt.
 - f. SFIs as the provider of fund bear the entire loss of *mudharabah* contract, unless *mudharib* (customer) makes intentional mistakes, negligent, or violate the agreement.
 - g. Principally, in *mudharabah* financing there is no guarantee, however, in order to avoid *mudharib* from misconduct or deviation, SFIs may demand guarantee from *mudharib* or third party. This guarantee can be disbursed if *mudharib* is proved of making violation against the agreement of contract.
 - h. The criteria of entrepreneur, financing procedure, and mechanism of profit sharing are regulated by SFIs in accordance with the fatwa of National Shariah Board.
 - i. The operating cost is borne by *mudharib*.
 - j. In the term of funding, in case the SFI does not conduct its obligation or violates the agreement, *mudharib* is entitled to have indemnification.
2. Accounting and Auditing Organization for Islamic Financial Institutions (Shariah Standards) on *mudharabah*.⁸²
 - a. Agreement of *Mudharabah* financing
 - It is permissible, on the basis of a general framework or a memorandum of understanding, to conclude *Mudharabah* financing contract for a particular sum of money and within a particular defined duration provided that the memorandum of understanding will be later implemented in line with specific or successive *Mudharabah* transactions.
 - The memorandum of understanding should define the general contractual framework, indicating the intention of the parties to use either unrestricted transactions or separate transactions.
 - If the *Mudharabah* contract is actually concluded on the basis of the memorandum of Understanding, the contents of the memorandum become an

⁸² AAOIFI, shariah standard No. (13) *Mudharabah*.

integral part of any future contract, unless the parties had originally agreed to exempt themselves from some of the obligations mentioned therein.

b. *Mudharabah* contract

- The *mudharabah* contract may be concluded using terms such as *Mudharabah*, *Qirad* or *Mua'amala*.
- Both parties should possess the legal capacity to appoint agents and accept agency.
- The general principle is that a *Mudharabah* contract is not binding, i.e. each of the contracting parties may terminate it unilaterally except in two cases:
 1. When the *mudharib* has already commenced the business, in which case the *mudharabah* contract become binding up to date of actual or constructive liquidation.
 2. When the contracting parties agree to determine a duration for which the contract will remain in operation.

c. Guarantees in a *Mudharabah* contract

The capital provider is permitted to obtain guarantees from the *mudharib* that are adequate and enforceable. This is circumscribed with a condition that the capital provider will not enforce these guarantees except in cases of misconduct, negligence or breach of contract on the part of *mudharib*.

d. Requirements relating to the capital

- In principle, the capital of *Mudharabah* must be provided in the form of cash.
- It is not permitted to use a debt owed by the *mudharib* or another party to the capital provider as capital in a *mudharabah* contract.
- The capital of *mudharabah* should be clearly known to the contracting parties and defined in terms of quality and quantity in a manner that eliminates any possibility of uncertainty or ambiguity.

e. Rulings and requirements to profit

- It is a requirement that the mechanism for distributing profit must be clearly known in a manner that eliminates uncertainty and any possibility of dispute.
- In principle, it is not permissible to earn a share of profit in addition to a fee in a *mudharabah* contract.

- The parties should agree on the ratio of profit distribution, then they should refer to customary practice, if any, to determine the shares of profit.
- If one of the parties stipulates that he should receive a lump sum of money, the *Mudharabah* contract will be void.
- No profit can be recognized or claimed unless the capital of the *mudharabah* is maintained intact.

2.5.3 Financing by complementary agreement

1. Hawalah

Islam recommends to pay off the debt if the debtor is able to pay and getting off responsibility. If someone is able to pay off the debt but he does undertake it, he has acted unjust (*zalim*). However, if he is unable to pay off the debt directly then it can be transferred to someone else. Here, the researcher will discuss about *Hawalah* briefly, so, for the further the reader is able to know it in detail in the *fiqh* book.

Hawalah is derived from the word *Tahwil* its mean *Intiqal* (transfer). According to the definition of etymology means transferring from one place to another. As for the meaning based on terminology, *Hawalah* is transferring the debt from one person's responsibility to another's responsibility with equal debt.⁸³ *Hawalah* has some sorts. Hanafi school divided it into some sections, namely:

- Hawalah muqayyadah* (restricted transfer) is the transfer in lieu of debt payment from the first party to the second party. In *hawalah muqayyadah* consist of:
 - *Hawalah al-haqq* is the transfer of right to sue a debt.
 - *Hawalah al-dain* is the transfer of obligation to pay off a debt.
- Hawalah mutlaqah* (unrestricted transfer) is the transfer of debt that is not defined as a change from the first party's debt payment to the second party.

Hawalah is permissible if complies with the requirements as the following:⁸⁴

⁸³Abdurrahman al-Jaziri, "*Kitāb al-Fiqh 'alā al-Madzāhib al-Arba'ah*", Vol. IV, (Beirut: Dar al-Kutub al-'Ilmiyyah, 1987), p. 353.

⁸⁴Sutan Remy Sjahdeini, "*Perbankan Islam dan Kedudukannya dalam Tata Hukum Perbankan Indonesia*", (Jakarta: Pustaka Utama Grafiti, 2007), p. 97.

- a. The parties who are involved in such *Hawalah* contract have to be qualified to take law, its mean must be rational or legal age.
- b. The existence of consent (willingness) from the both parties.
- c. The debt which has been transferred is something that has been packed in the form of a certain account.
- d. Both accounts should be exactly equal, in quality and quantity as well.

The application of *Hawalah* contract in Islamic microfinance⁸⁵, namely:

- a. Factoring⁸⁶ if the customer who has a debt to the third party and he transfers it to the bank, so that the bank will pay and collect debt from the third party.
- b. Post-date check i.e. the IMFIs act as a receivable clerk, without paying for any debt formerly.
- c. Bill discounting. Principally it is similar to *Hawalah*. The distinction is that in the bill discounting the customer has to pay a fee, whereas in *Hawalah* contract the fee is not required.

Practically⁸⁷, *Hawalah* contract is executed for many purposes, for example for the purpose of family member⁸⁸, school fees, medical expenses or if the member has a debt in another party, while his debt has a final due date, subsequently, the member asks BMT to pay the debt. Actually, the BMTs charge the customers a fee⁸⁹ which is called in the term of *fiqh* as *ujrah*. This practice is contrary to the principle of *Hawalah* as *tabarru'* contract.

Islamic Financial Institutions are allowed to operate the product of *Hawalah* with all various provisions. Ulama of *fiqh* determined many parties that must be fulfilled in the term of *hawalah* contract, namely: *Muhil* (those who have debt), *Muhal/Muhtal* (people who have

⁸⁵M. Syafi'i Antonio, Op. Cit, P. 127.

⁸⁶In conventional business, factoring is a financial transaction and a type of debtor finance in which a business sells its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount, See: Richard Burton Simatupang, "*Legal Aspect in Business*", (Jakarta: Rineka Cipta, 2003), p. 109.

⁸⁷ An interview with the head of PINBUK (Mr. Endang ahmad yani), on march, 20 2014.

⁸⁸The member which has been mentioned here means the customer. Although BMT is the one of Shariah financial institution, but its position is under the shade of cooperatives, so that the customer is not used in the term of BMT, but it has the same meaning as member.

⁸⁹ According to fatwa National Shariah Board No: 12/DSN-MUI/IV/2000 on *hawalah* stated that the offer and acceptance should be stated by the parties to show their will to execute the contract. From this, the agreement of contract should be agreed by the third party.

debt to *Muhal*), *Muhal 'alaih* (the people who owe against *Muhal* and the debt shall be paid to *Muhtal*), *Muhal bih* (the debt of *Muhal* against *Muhtal*) and *Sighat* (*ijab* and *qabul*).

The relation with the term of Bank that *Hawalah* contract is set for Islamic Banking by the decree of the Director of Bank Indonesia No. 32/34/KEP/DIR⁹⁰ about Shariah commercial bank. General provisions regarding *Hawalah* contract in Islamic Banking is being applied in Islamic banking operations, there are some provisions that must be considered. Those provisions are deemed clear enough. Along with the development of Islamic Financial Institutions in Indonesia, so the rule which has been applied shall be developed to legalize and protect the contract-agreement according to Shariah principle.

Following are the benefits of *Hawalah*:

- a. A quick, an easy and simultaneous debt settlement
- b. As a bridging fund of *hibah* for the needy
- c. As one of fee-based income for BMT or as a revenue-based not financing.

In addition to the benefit, the risk of *hawalah* may occurs BMT i.e. the fraudulence of customer by giving a fake invoice to fulfill their *hawalah* obligation. Following the process flow of *Hawalah* in BMT:

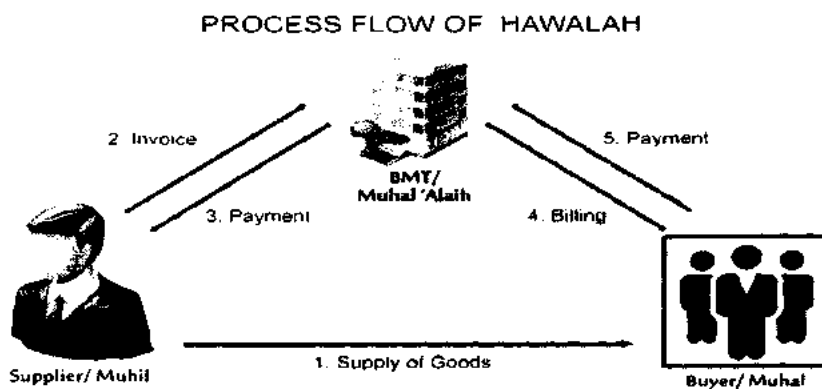


Figure 10: Process flow of *Hawalah* in BMT

⁹⁰See <http://www.scribd.com/doc/58606339/SK-32-34-kep-dir>. (Accessed on 31/03/2014).

2. Interest Free Loan (*Qard Hasan*)

The term *Qard hasan* has been briefly and explicitly discussed in the first chapter, however in this chapter the researcher would like to highlight on how it is being operated in BMT's.

Qard Hasan Fund raising in BMT

According to the table of BMT's products mentioned before, only BMT An-Nahl and BMT Al-Bina operate this product. While the rest of BMTs are not operating it due to inadequate fund of ZIS (*Zakah, Infaq, Shadaqa*)⁹¹ and high risks are suffered by them. *Qard hasan* contract will not provide financial benefit. Therefore the *qard* funding might be taken from the below categories:

- a. *Al-qard* is provided to assist the customer's financial needs with a quick payment and short-term. The bridging fund can be taken from the capital of BMT.
- b. *Al-qard* is needed to assist the small enterprises and public social needs, the source of this fund can be allocated from *Zakah, infaq* and *Shadaqa*.

Qard hasan financing is a soft loan given to the members who are really short of capital and for those who are desperately need of emergency purposes. Customers (members) are simply repay the loan in accordance with the values given by BMT.

Opinions of Indonesian Council of Ulama and AAOIFI (Shariah Standards)

1. Fatwa of National Shariah board – Indonesian Council of Ulama No: 25/DSN-MUI/III/2002 about *qard hasan* are mentioned below:

First: the general provisions of *qard hasan*:

1. *Qard* is a loan given to the needy customer (*muqridh*).
2. The customer of *qard* has to repay fully payment at the agreed time.
3. The administration expense is born by customer.
4. The IMFI can demand the customer to give collateral.

⁹¹An interview with the head of PINBUK Tasikmalaya Endang Ahmad Yani on march 25, 2014.

5. The customer of *qard* can demand an extra charity toward IMFI as long as not mentioned in the contract.
6. If the customer cannot return half or full payment at the agreed time, and the IMFI has evaluated their incapability, the IMFI could:
 - a. Extend the repayment period.
 - b. Write off most/all their liabilities.

Second: Sanction

1. If the customer is unable to repay the loan without any reasonable reasons, IMFI could impose them a sanction.
2. The sanctions which are given by IMFI can be (are not limited on) the sale of collateral.
3. If the value of collateral is insufficient, the customer is obligated to fulfill their liabilities.

Third: Source of *Qard* funds

1. Paid up capital of IMFI
 2. The reserved profit of IMFI
 3. Any institutions or individual who entrust the distribution of *infaq* toward the IMFI.
2. Accounting and Auditing Organization for Islamic Financial Institutions (Shariah Standards) on *Qard hasan*.
 - a. Rules for excess benefit stipulated in the *qard hasan* contract
 - The stipulation of an excess for the lender in loan is prohibited, and it amounts to *riba*, whether the excess is in the term of quality or quantity or whether the excess is tangible thing or benefit.
 - It is permitted to stipulate the satisfaction (repayment) or *qard* at a place other than that where the loan was made.
 - b. Rules for excess benefit not stipulated in the *qard hasan* contract

- It is not permitted to the borrower to offer tangible property or extend a benefit to the lender during the period of the *qard* when this is done for the sake *qard*, unless the giving of such benefits is a practice continuing among the parties from a time prior to the contract of *qard*.
 - An excess over *qard* is permitted in terms of quality or quantity, or the offering of tangible property or extending of a benefit, at the time of satisfaction when it is not stipulated or is part of custom.
- c. Service charges for *qard*
- It is permitted to a lending institution to charge for services rendered in loans equivalent to the actual amount directly spent on such services. It is not permitted to the institution to charge an amount in excess of such a service charge.
 - Indirect expenses incurred in rendering services for loans are not included in actual expenses, like the salaries of the employees, the rentals of space, asset and means of transport as well as other management and general expenses of the institution.

***Qard hasan* financing mechanism in BMT**

1. Customers apply for financing toward BMT along with the attachment of identity card, copy of collateral ownership and letter of poverty.
2. The BMT which is represented by account officer observes and analyzes the condition of customer (on the spot), also analyzing the submission of customer's financing.
3. Account officer holds the meeting of committee to analyze the customer feasibility by considering the director's proposal and the internal unit supervisor.
4. When there is a decision of customer's financing approval, the account officer demand the customer to complete the financing agreement document, letter of collateral ownership, etc.
5. The financing administrator checks the sufficient document.
6. The financing agreement is undertaken by customer and BMT
7. The financing disbursement can be undertaken by customer from the teller.

Following the process flow of *Qardh hasan* in BMT:

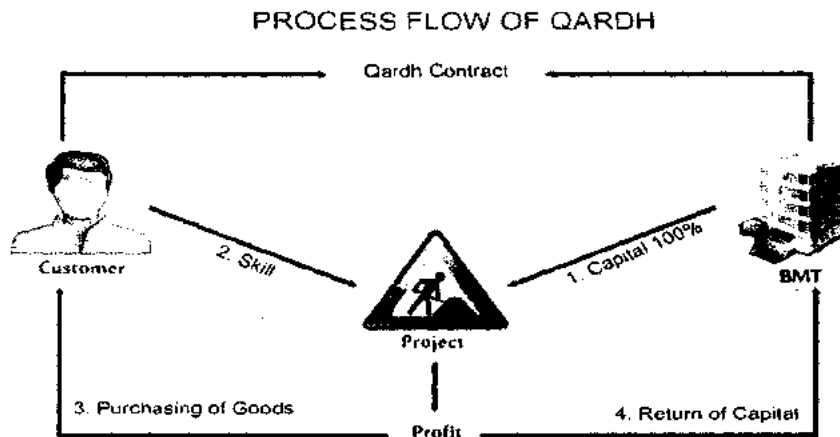


Figure 11: Process flow of *Qard hasan* in BMT

Explanation:

- a. BMT and customer conduct financing agreement with *Qard hasan* agreement.
- b. BMT as the provider of funds 100%
- c. The customer as a labor or the manager of BMT's fund.
- d. The profit is given to the customer 100%
- e. BMT gains 100% return of the capital.

Following are the benefits of *Qard Hasan*:

- a. Customer who is in desperate needs of financial assistance is possible to get fund by bridging loan.
- b. *Qard Hasan* is a distinguish product of conventional microfinance and it has a social mission beside commercial as well.
- c. The emergence of this product as well as its social mission can enhance the positive image and the loyalty of society toward IMFIs.

The risk of this product is so high due to it has been regarded as a financing without any collateral.

2.5.4 Funding Product

1. Wadi'ah

The word *wadiah* is derived from the word *wada'a*, the synonym of *taraka* it means to leave. Something that is deposited by one person to another to be kept is *wadi'ah*.⁹² *Wadiah* is safekeeping deposit. Such as deposit which is being held in trust (*Amanah*). If the depositor pays for this favour, the depositor needs to replace it in case of lost. The usage of the deposit is subject to depositor's permission.⁹³ According to Indonesian law No. 9 year 1995 No. 254 year 1992 *wadiah* is a fund entrusted by cooperative's members in the term of saving and time deposit. According to BMT *wadiah* is a fund entrusted by member in which the contract has been agreed by both parties, and the depositor will earn profit from BMT's profit.

BMT implements *wadi'ah dhamanah* on all deposit products, because BMT assume the lump sum of money which is deposited by the customer as *wadiah* must be carried out and accounted for. Funds or money that has been generated will be managed optimally, so that the expected profit will be obtained.

Following are the applicable provisions on *wadiah* in BMT:

- Time deposit can only be withdrawn at the day of maturity, unless getting approval from the local director and paying the administration fee in accordance with applicable regulations;
- Time deposit will be renewed automatically;
- If the time deposit is disbursed or the duration is altered, then the depositor should let the BMT know at the latest 3 (three) working days prior to the due date;
- If bilyet giro/deposito⁹⁴ is lost or stolen, the depositor must give a report to the bank immediately along with the attachment of police missing certificate;

⁹²Ahmad wardi muslich, "*Fiqh Muamalat*", (Jakarta: Amzah, 2010) p. 455.

⁹³See, <http://wiki.islamicfinance.de/index.php/Wadiah>. Accessed on june 17, 2014.

⁹⁴Bilyet giro is a non-negotiable debit instrument, which is very similar in nature to cheque. The main differences are that bilyet giro cannot be disbursed by its holder and it can be post dated. See, (Payment, clearing and settlement systems in Indonesia.pdf)

- If bilyet giro/deposito is submitted to BMT as collateral, the deposited amount cannot be disbursed as long as it becomes a guarantee;
- If the time deposit is conducted on behalf of the two people, then:
 - a. If one party dies, the owner who is alive has a right to withdraw the deposited amount at the due date if there is no predetermined inheritee designation letter.
 - b. If one party prohibits the payment to the other party, so BMT will not able to pay unless the concerned party has settled the issue.⁹⁵

Following are the products of *wadiah* in BMT :

1. *Wadiah Ummat*

Wadiah ummat is the deposit of third party which is used by BMT where the third party achieves revenue sharing of the total number of deposit.

2. *Wadiah* for Education

Wadiah education is provided for the students who are intended to continue their educational programs.

3. *Wadiah* for *Qurbani* purpose

Wadiah for *qurbani* purpose is provided for the sacrificial worship preparation.

4. *Wadiah* for *Walimah* (marriage)

Wadiah for *walimah* is provided for marriage preparation and the profit is being shared per month.

5. *Wadiah* for old age

Wadiah for old age is provided for the needs of pension time.

6. *Wadiah* for *Hajj/Umra*

Wadiah for *hajj/umra* is provided for *hajj* and *umra*

7. *Wadiah* for the birth mother

It is specially provided for the preparation of their birth

8. Short time *Wadiah*

This product is the huge amount of deposit of third party either personally or institutionally given by time of deposit.

9. *Wadiah Amanah*

⁹⁵ Taken from the data provisions and conditions on the opening time deposit account in BMT (PINBUK).

In addition to provide saving and loan, BMT become charity of institution i.e. channelize *zakah, infaq, sadaqa, wakaf* and *hibah* either in the form of fund or commodity.

The benefit of *wadiah* For BMT:

- a. It enables BMT to increase its capital
- b. It is source of fund in financing
- c. It can be adopted as collateral

Following are benefits of *wadiah* for customer/member:

- a. To build thrift
- b. Instilling confidence
- c. Earning profit
- d. To educate the member/customer in household economy arrangement
- e. To enhance social welfare
- f. To increase depositor's income

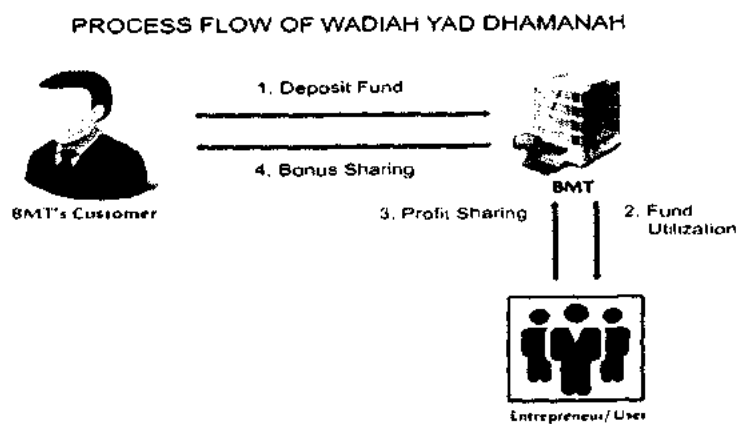


Figure 12: Process flow of wadiah yad dhamanah in BMT

The principle of *wadiah*:

- a. BMT shall not use and distribute funds/goods which are stored/deposited.
- b. Ensuring the funds or goods may be withdrawn by the owner at any time.
- c. BMT May charge administration fee.

Distribution of profit:

- a. The profit is calculated at the end of the month and directly credited to the account of member;
- b. For the product of *wadiah ummat* and education, the proportion of the actual profit to which each partner is 35:65 (customer : BMT);
- c. The ratio of the profit for the product of *wadiah qurban* to *wadiah* for the birth mother is 38:62;
- d. The proportion of the actual profit of Short time *wadiah* is determined by the given period of time:
 - For 1 month term deposit is 38:63
 - For 3 month term deposits is 40:60
 - For 12 month term deposits is 50:50
- e. For the product of *wadiah amanah*, BMT takes its part as *zakah* institution which is channeling funds to *qardh hasan* financing and charity for social activities, scholarships.

2. **Zakah**

Zakah in language is an infinitive of the verb *zakah*. *Zakah* means to grow and to increase. When it is said about a person, it means to improve, to become better. Consequently *zakah* is blessing, growth, cleanliness, and betterment. In Lisan al-Arab it is said, "The root of the word *zakah* in Arabic means cleanliness, growth, blessing, and praise. All these meanings of the word are used in Qur'an and Hadith. "It seems to be most obvious according to al-wahidi and others that the root "*zakah*" means increase and growth. For example, with respect to plants it means to grow and with respect to things, it means to increase. But since plants grow only if they are clean of insects and other detrimental things, then the word "*zakah*" implies cleanliness and cleansing. If it is used with respect to persons, *zakah* then means

betterment and righteousness. You may say a man is *zaki*; that is, he has good character, or you may say that the judge *zakah* the witnesses to mean he shows that they are of a higher level in their testimony.⁹⁶

Economic empowerment and meeting immediate basic consumption needs do not need to be mutually exclusive. In any program of economic enhancement through *zakah*, satisfying immediate basic needs of the poorest must always be regarded as the top priority. Because the main objective of *zakah* is to pull a Muslim out of the biggest issue that is economic trap that occurs distress by providing for his/her basic needs.

In a subsequent phase, the beneficiaries may be made to go through skill-improvement programs through meeting their cost of education and training with *zakah* funds.⁹⁷ *Zakah* funds may also be provided as startup capital for their micro-enterprises in such form of loans (*qard hasan*) or micro-equity without expectation of any returns depending upon the degree of their difficulty. This would be the best strategy to enable the poor to raise up their livelihood degree and transform them from the category of *zakah* recipients (*mustahiq*) into *zakah* payers (*muzakki*). And it is a strategy of poverty eradication and economic empowerment projects through efficient collection and distribution can be undertaken by the state or not for profit organization like *zakah* fund such as BAZNAS (the national board of *zakah*) in Indonesia or BMTs. BAZNAS or BMTs will manage *zakah* fund and distribute it to the beneficiaries.

The emergence of *Qard Hasan* product is the sole solution to optimize *zakah* fund (*infaq* and *sadaqah*). Most of ulemas are aware that the obligation of *zakah* payment is one of the major breakthroughs offered by Islam in the interaction of socio-economic system throughout the history of mankind as a solution to reduce poverty, fostering social solidarity among the society, reducing the gap and the most important as the capital investment of *mustahik* to overcome their difficulties of life. Moreover, *zakah* fund become a buffer for the borrower (*Qard Hasan*) who suffers financial difficulties to repay the loan.

Distribution of *Zakah* technique in BMT

The term of bait al-mal or Bait al-Mal wa at-Tamwil currently popular in Indonesia with the rise of the spirit of ummah to use Islamic economic. Bait al-mal in connection with BMT

⁹⁶Dr. Yusuf al-Qaradawi, "*Fiqh al-Zakah: A Comparative Study of Zakah, Regulations and Philosophy In The Light of Qur'an and Sunnah*". Translated by Dr. Monzer Kahf, (Jeddah: Scientific Publishing Centre King Abdulaziz University, vol I).

⁹⁷Mohammed Obaidullah, Op. Cit, p. 41.

has many activities that receive and distribute *zakah*, *infaq*, and *sadaqah* not for commercial oriented. It is focused on the distribution to its beneficiaries that has been specified in the holy Quran with the main priority for the poor. BMT with its function is to operate *qard hasan* not for commercial oriented but for social well-being and economic development.

For the future development, the management of *zakah*, *infaq*, and *sadaqah* has been accommodated with the enactment of law No. 38 of 1998 concerning the management of *zakah*. However, the BMT still significantly remain as an institution that directly in contact with the grass roots of the poor, having a great opportunity as business partner of *zakah* institution.

For the unproductive *mustahiq* who does not have potential to be empowered, the *zakah* fund will be given to them in such of their basic necessities including food, shelter, clothing, health and education based on *had al-kifayah* (adequacy calculation). The principle of this program is emergency case, limited and selective.

For the productive *mustahiq* who has potential to be empowered, the *zakah* fund will be distributed in the form of their basic assistance i.e. working capital to create their business, either for enhancing the capability and skill or for the working capital. The principle of this program is to encourage the target group in increasing their welfare as well as sustainable development.

1.4 The Impact of BMTs on poverty alleviation in Tasikmalaya Indonesia

Poverty, in Islamic perspective, is viewed not just from material side but also moral side, as well being has two sides: material and spiritual which include mental peace, happiness and social harmony, then to realize it, it imposes justice and human brotherhood, without looking at gender, race, age etc.⁹⁸

The prolonged economic crisis in Indonesia has led to the increasing number of poor and unemployed. The issue of poverty is an issue of Indonesian society and the world as a whole which has to be looked for its solution. Until now, poverty is still a big issue in the development of the society both in rural and urban areas.

⁹⁸Umer Chapra, "*Islam and Economic Development : A Strategy for Development with Justice and Stability*", (New Delhi: Adam Publishers & Distributors, 2007), p. 6.

It should be noted that BMTs in Tasikmalaya at the grassroots widely fall outside the financial regulatory mechanism since they operate as member-based cooperative organizations without governmental intervention or assistance. According to Central Bureau of Statistics (BPS) in 2013 indicated that Tasikmalaya ascertained as the highest poverty rate in West Java, from the total 646.874 population, 129.759 people or 19,98 percent are stated poor and 59.124 people are unemployed or jobless.⁹⁹ The reason is due to the low rate of sale among society. It is very ironic, the government that own the budget cannot afford to make welfare for the society, due to lack of seriousness in IMF1 development. Whereas, the BMT with its capabilities can produce a great asset Rp. 24.198.434.659 (\$ 2.3 million) that can improve the welfare of social economy. BMT has a prominent role to empower social economy. BMT can provide financial assistance to the people who need it to create new business, it touches to the bottom of the level, also can create a productive economy. Therefore, the government's support is really needed. For the Number and Percentage of People Living under Poverty in West Java, Indonesia 2010 by Regency/City shown in the following table:

Table 6: Number and Percentage of People Living under Poverty

Regency/City	Number of poor people (000)	Percentage of Poor People %	Poverty Line
1	2	3	4
Regency:			
01. B o g o r	477,1	9,97	214 338
02. Sukabumi	249,5	10,65	184 127
03. Cianjur	310,9	14,32	202 438
04. Bandung	296,2	9,30	217 452
05. G a r u t	335,6	13,94	180 406
06. Tasikmalaya	214,5	12,79	186 126
07. C i a m i s	158,4	10,34	208 960
08. Kuningan	152,4	14,68	200 171
09. Cirebon	333,3	16,12	230 346
10. Majalengka	181,1	15,52	263 377
11. Sumedang	141,4	12,94	230 637
12. Indramayu	276,0	16,58	264 576
13. Subang	198,3	13,54	234 803
14. Purwakarta	90,3	10,57	226 118
15. Karawang	260,2	12,21	266 597

⁹⁹BPS Tasikmalaya (<http://tasikmalayakota.bps.go.id/>). Accessed on 28 August, 2014.

16. Bekasi	161,7	6,11	271 901
17. Bandung Barat	222,9	14,68	216 388
City:			
18. Bogor	90,2	9,47	278 530
19. Sukabumi	27,7	9,24	284 339
20. Bandung	118,6	4,95	279 784
21. Cirebon	35,5	12,00	251 375
22. Bekasi	148,0	6,30	332 849
23. Depok	49,6	2,84	310 279
24. Cimahi	40,1	7,40	280 155
25. Tasikmalaya	131,5	20,71	263 177
26. Banjar	14,8	8,47	193 305
West Java	4716,0	10,93	230 445

Source: www.jabarprov.go.id/root/dalamangka/dda2012.pdf

Table 7: Employment Indicators in Tasikmalaya, 2011

Indicator	Male		Female		Male+Female	
	Total	%	Total	%	Total	%
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Job Opportunities Level (TKK)	167.802	90,13	85.911	92,31	253.713	90,86
Unemployment Level (TPT)	18.368	9,87	7.157	7,69	25.525	9,14
Labor Degree Participation Level (TPAK)	186.170	80,92	93.068	41,08	279.238	61,15
Population with age 10 years above working based on vocation:						
1). Agriculture, Horticulture, Husbandry, Forestry and Fisheries	15.465	9,22	6.797	7,91	22.262	8,77
2). Manufacturing Industry	58.236	34,71	35.149	40,91	93.385	36,81
3). Trade, Hotel, and Restaurant	31.875	19,00	29.676	34,54	61.551	24,26
4). Social Service	26.398	15,73	12.553	14,61	38.951	15,35
5). Others: (Mining & Quarrying, Electricity, Gas & Water, Building, Transport, Warehouse Communication, Finance, Insurance, Rental building, Land & Business Services)	35.828	21,35	1.736	2,02	37.564	14,81

Total	167.802	100,00	85.911	100,00	253.713	100,00

(Source: BPS Tasikmalaya 2011)

TKK: Number of worker divided by number of population of labor level

TPT: Number of Unemployment divided by number of population of labor level

TPAK: Number of worker plus unemployment divided by the population with age 10 years above

From the above table it shows the Unemployment Level is still high,

- a. It reaches 25.525 people or 9,14%. In 2008 unemployment rate reached at 10,87%, in 2009 at 8,41%, in 2010 decreased until 8,16.¹⁰⁰
- b. The employment and business opportunities are not comparable with the growth of the labor rate
- c. Employment information system is still limited
- d. The awareness of the worker still remains low.

Poverty reduction strategies have been conducted by the government. Started from assistance between individual and the group as the target such as direct cash assistance to the poor, and other non-cash such as rice for the poor (Raskin), medical assistance (Askeskin) and education (BOS and BKM), IDT, JPS, PEMP and etc, but in fact the poor people are not reduced by considerable amount. This system is only solving the poverty problem in short-

¹⁰⁰See, (<http://tasikmalayakota.bps.go.id/>). Accessed on 28 August, 2014.

term. As step to realize economic growth for the poor or the poorest is the distribution of funds from a variety of sources e.g. ZIS (*Zakah, Infaq, Sadaqah*).

The impact of *zakah* and BMT's financing on poverty reduction

In developing countries, there are a lot of issues that can hamper to the further development. One of the major attentions of the government is poverty. The high level population and poverty should become a trigger for the success of government development programs. This is happened due to the dualistic economic structure continues, so that, the people are continually at risk of slipping back into poverty. The modern sectors are controlled by the capitalist who has already established and are making coalition with the power elite, while most of the people in rural areas are still living in traditional agrarian sector and rural informal sectors of the economy. Second, the political and social structures still not have changed that much even after passing through the New Order period (Orde Baru).

Umar Bin Abdul Aziz had provided solution and set a good example in alleviating poverty based on Islamic concept. In economic structural change, he put some attentions in his power and he embraced vulnerable people. He left the glamour lifestyle which had been felt since he was a little young boy to serve the vulnerable people for the better life. He argued that the rules do not serve to protect the capitalist, but it should drive to the justice as well as the economic equality driven by *zakah* concept to eliminate the gaps between the poor and the rich. From this Islamic perspective, we conclude that *zakah*, creating new jobs, BMT, and education have played major role towards poverty.

From this, the researcher is interested to seek the effect of *zakah, infaq, sadaqa* and BMT's financing in alleviating poverty in Tasikmalaya based on Religious String Approach. The holy Qur'an is the source of knowledge given to mankind in order to make epistemology structure, its teachings are relevant for every age and comprehensive as well (*rahmatan li al-alamin*). The Qur'an is given by Allah as revelation to mankind through suratic process.¹⁰¹ Driven by understanding of this relationship, the society can create wide world concept based on Qur'an and Sunah. Therefore, through the integration and interaction will emerge the social wellbeing function gradually and sustainable.

¹⁰¹ Suratic process is a process relates to the human and nature. It will emerge strong integration and interaction as a sign of united consensus. This integration is followed by evolution process. (see: Masudul Alam Choudhury "Islamic venture capital: A critical examination *Journal of Economic Studies*", Vol. 28 No. 1, 2001, pp. 14-33).

According to the research which has been conducted by using secondary data, following are the results:

First, the impact of variable of *zakah* on poverty indicates that *zakah, infaq, sadaqah* can reduce poverty in Tasikmalaya. And the highlight part of this research that the role of ZIS in reducing poverty is still small, because the role of *zakah* institution in Tasikmalaya is not really optimal and the poor people are feeling better to achieve *zakah* fund directly by hand.

Second, the impact of BMT on poverty indicates that the financing can reduce poverty in Tasikmalaya.¹⁰² because BMT is an Islamic microfinance institution that can develop the productive economic activities i.e. encouraging saving and helping the financial member or society, where this fund will encourage people to create business, so that the poverty which is shrouding family can be overcome.

Third, the poverty in Tasikmalaya impacts the role of ZIS and financing, if the number of poverty increase, the number of ZIS and financing will decrease.

Following are the suggestions that should be noted:

1. BMT can reduce poverty although its impact is still small, it is the obligation of government to provide funds for BMT financing to accelerate the poverty. So, the people will prosper and the role of BMT as a tool of poverty alleviation can be optimized.
2. Although the impact of ZIS instrument is still small on poverty reduction in Tasikmalaya¹⁰³, nevertheless the policy maker of this city is expected to optimize the role of this instrument in poverty reduction.

¹⁰² Based on interview with the head of BMT in Tasikmalaya Mr. Endang Ahmad Yani he is stated that the role of *zakah* and BMT's financing for the members of BMT is fortunately impacting their livelihood and is lifting their social status as well. Following are the impacts of *zakah* and BMT's financing:

- The revenue of the member increases
- Every household can get educational program
- The people can create new business with fresh working capital which is given by BMT
- From the total number of SMEs (mostly 320 entrepreneurs) which are registered in BMT, there are 283 people of small and medium enterprises who has accessed financing from BMT (91,29%) and they conclude that BMT as the only source to obtain financing.

¹⁰³ According to the National Tithe Collecting Agency (BAZNAS) Tasikmalaya, that the collected amount of *zakah* in 2011 was Rp. 2 billion (\$2 million at that time), out of the expected amount that estimated at Rp. 10 billion (\$10 million).

If the two suggestions are implemented, the researcher believes that poverty reduction program will be accelerated well. Our nation will have economic independence, so that, the sovereignty and honor of the state can be maintained.

CHAPTER III

SHARIAH AND LEGAL ANALYSIS OF THE OPERATION OF COOPERATIVE CORPORATION FOR BMT

3.1 Introduction

National economic development relies on various aspects of its foundation, one is financial institution. People utilize services of financial institution as a place of investment or obtaining a loan in order to develop their business activity. Thus, the financial institution in a country have great role in the wellbeing of the people and prosperity of the society. The issue of shariah legitimacy of such institutions, however, remain a matter of concern for every committed Muslim.

There is a growing concern with regards to shariah legitimacy of the transactions of BMT. In the following lines, we will study and examine the activities of BMT from shariah perspective. The question is whether said economic activity is part of riba or not?

Majority of Muslim society do not want to get involved with the conventional banking even though it is realized that the bank plays a big role in the national economic building. From this reality, it is certain that IFIs can fulfill the demand of the society and the economic activities can be performed in accordance with Shariah principles. Bank Muamalat Indonesia emerged as a pioneer Islamic bank which has been working on the development of IMFIs e.g. BMT since the financial crisis strongly hit the Indonesian people. Bank Muamalat Indonesia enhanced the public confidence on the IFIs. The existence of IMFIs e.g. BMT can be the excellent way of helping the groups which are economically weak to meet the needs of capital for business. In addition to the profit-oriented based, IFIs is also subject to the poverty alleviation.

BMT is growing rapidly and surely it can enhance the prosperity of society. Nevertheless, it should be noted that the emergence of legal issues regarding BMT have potentially caused the dispute. In this chapter, the researcher will highlight the cooperative law in the Islamic perspective, BMT's legal body, relative legal issues and its dispute settlement.

3.2 Cooperative Law regarding BMTs in Islamic Perspective

The discussion on the spectrum of Islamic law is a vast and a broad area. The term of legal determination can be undertaken by the procedures and various methods. If the legality of an issue is not explicitly mentioned in the Qur'an and Sunnah, then the legal determination can be undertaken by *ijtihad*, so that the legal determination methods can be applicable, those are *qiyas*, *ijma*, *istishab*, *istihsan*, etc. which can be used in the determination of cooperative law.

According to Mahmud Syaltut, cooperative (*shirkah at-ta'awuniyah*) is a new form of unknown *shirkah* among the classic jurists¹⁰⁴ who segregates the *shirkah* into *Shirkah Abdan*, *Mufawwadah*, *Wujuh*, and *Inan*.¹⁰⁵ Some scholars assume that cooperative (*shirkah ta'awuniyah*) as *mudharabah*.¹⁰⁶ Mahmud Syaltut does not agree with this opinion, because it does not contain the element of *mudharabah* as defined by scholars (one party provides a capital and other party undertakes a business) because according to *shirkah ta'awuniyah* in Egypt, its capital is raised from the shareholders and it is managed by the board and the employee. If the shareholders are involved in such services of management, they are paid for their services according to prescribed regulations.¹⁰⁷

According to Mahmud Syaltut, cooperative is a new form of *shirkah* created by the expert economists. The main characteristics are as follows:

- it is rich in benefits given to the member of shareholders;
- it gives a job to its employee;
- it provides financial aids of some cooperative's profit to establish place of worship;
- it gives education without injustice and discrimination;
- it manages democratic societies;
- it gives loss and profit sharing to all members as per applicable regulation. This kind of *shirkah* is justified in Islam.¹⁰⁸

¹⁰⁴ *Shirkah abdan*: joint business, *shirkah mufawwadah*: cooperation with the same capital of money or services, *shirkah wujuh*: cooperation based on the trust worthy of profit sharing contract, *Shirkah 'Inan*: cooperation based on profit and loss sharing in accordance with the amount of each capital. Mahmud Syaltut, "Al-Fatwa", (Egypt: Dar el-Qalam), p. 349

¹⁰⁵ Sayyid Sabiq, "Fiqh Sunnah", Volume III, (Libanon: Dar el Fikr, 1981), p. 294-298

¹⁰⁶ Ibid., p. 212

¹⁰⁷ Mahmud Syaltut, Op. Cit, p. 348

¹⁰⁸ Ibid., p. 349-350

While Abdurrahman Isa stated that *shirkah ta'awuniyah* (cooperative) is *shirkah musahamah* in which its shares are purchased by the member. He further explains that it is kind of *shirkah amwal* (board of capital) not *shirkah ashkhas* (association of persons) because the personality of shareholders is disappear in cooperative. According to the opinion of Abdurrahman Isa, the cooperative is permissible and accepted concept in Islam as long as it does not involve any usury and illicit businesses.¹⁰⁹

Asnawi Hasan found that cooperative is shariah compliant concept and noted that the muslim ummah prefer to participate in building and developing cooperative.¹¹⁰ Khalid abdurrahman ahmad, the middle east author argue that the cooperative is prohibited (haram) for every muslim. He further says that Islam forbids the wealth earned from cooperative.¹¹¹ The reasons of prohibition of cooperative are:

- The principle of institution is not appropriate with shariah compliant, such as restricting one of the community to become the member.
- Distributing profits proportional to purchases or according to production, rather than relative to the capital or relative to the work is not allowed. If the company was concluded on the basis of capital then the profit should be determined by the capital, and if it was concluded on the basis of work it should also be determined by work. So the profit follows either the capital or the work, or both of them.
- According to the main objective of cooperative, it is stated that the requirement of member should come from the people who are economically weak. But in reality, it only aims at bringing them to the uneven prosperity.

Taqyudin an-nabhani supports this idea and says that in cooperative, obviously, there is capital and the distribution of profit is based on the purchase or production, not according to the capital or labor.¹¹² This prohibition is taken from the result of *ijtihad* which its degree is *Dzanni* (probable). This prohibition could not be applicable in Indonesia, because the objective of cooperative is to prosper its members and they are not required only for the people in which their economy are weak. In this regards the entire of Indonesian people are

¹⁰⁹ Abdurrahman isa, "*Al-Mu'amalat al-Haditsah wa Ahkamuha*", (Egypt: Mathba'ah Mukhaimin), p. 65-68

¹¹⁰ Asnawi hasan, "*Koperasi dalam Pandangan Islam, suatu tinjauan dari segi falsafah etik, dalam Membangun sistem ekonomi dan demokrasi ekonomi, Sri Edi Swasono (ed)*", (Jakarta: UI Press, 1987), p. 173

¹¹¹ Khalid Abdurrahman Ahmad, "*Al-Tafqir al-Iqtisad fi al-Islamiyah*", second edition, (Riyadh: Maktabah al-Madinah, 1976), p. 140-142

¹¹² Taqyudin An-Nabhani, "*Building an alternative economic system islamic perspective*", second edition. Translated by M. Maghfur Wachid, (Surabaya: Risalah Gusti, 1996), p. 189-190

suggested to be cooperated. It can be concluded that the business in cooperative classically or in Islamic tradition does not recognize the distribution of profit on the basis of purchase and sale and because of this reason, cooperative is rejected, but this conclusion is not agreed by the consensus of ulama.

However, the term obligatory which is appointed toward cooperative activities for the muslim ummah in Indonesia is still unacceptable yet. Because, first the constitution believes that there are three businesses which can be incorporated under the regulation of Indonesia, namely cooperative, private and BUMN (State-Owned Enterprises (SOEs) or Government-owned Corporation (GOC)), though cooperative has been regarded as "Soko Guru" the pillar of national economy. Secondly, the economic resources for the muslim ummah are so wide so that it can take a part in everywhere, not just in the cooperative activities. Third, the cooperative from the beginning of its formation needs voluntary. While the Fourth, its scope is still limited and it is difficult for people to reach cooperative.

In addition to the ethical values of cooperative, the determination of cooperative law can be considered under the rule of *ushul al-fiqh*, where the Islamic law is allowing the public interest or public welfare through the principle of *istislah* or *al-maslaha*. As a result, the Islamic economy focus on the social welfare which is the main public interest, if the role of cooperative is considered as a tool of economic struggle, social welfare enhancement and economic democratization, the principle of *istislah* will be fulfilled by cooperative.

Likewise, the cooperative can be measured by *istihsan* (preference method) from macro and micro side. At the macro side it can be considered as the closer economic system to Islamic ruling than capitalist and socialist system. While at the micro side it is considered from the fulfillment of social relationship principle with mutual pleasure. So that it can be reflected to the principle of open membership and voluntary, as well as concerning with the principle of solidarity and service member.

From this, the method of *istinbath* (deduction of shariah law) against the cooperative is applicable, whether it is obligated or prohibited. According to the *istinbath al-ahkam* through *ijtihad*, its legal status relies on its character as *muamalah* practice, as a result the cooperative is permissible in Islam. As shariah maxim says:

“The norm in regard to things is that of permissibility except that is expressly forbidden by law”.

3.3 Conformity of cooperative principle with Islamic Cooperative

The discussion about economy in Islamic teaching includes the aspect of *muamalah* that has two kinds, namely relating to the fulfillment of material needs (*muamalah madiyah*) and social intercourse (*muamalah al-adabiyah*). Combining both of the two aspects of *muamalah* are seemed to have similarity with cooperative's goal i.e. to empower social economy. For the further, the cooperative will be viewed in respect of Islamic teaching or framework. Cooperative is the economic organization which has different characteristics with other economic organizations. The difference lies in the ethical value system underlying in the life and expressed in the principle that serve as the ethical norms or behavior of the cooperative as the economic controller. The main character of cooperative is membership cooperation which aims at gaining the social welfare.

From the above definition and characteristics, it can be concluded that the philosophy or ethic that is underlying the cooperative's idea is cooperation, mutual assistance and economic democracy leading to the general welfare. Keeping the view of philosophy or ethics which underlie the cooperative movement, we can find many similarities in cooperative i.e. emphasizing the importance of cooperation, mutual help (*ta'awun*) and brotherhood (*ukhuwah*). In Islam cooperation and mutual help is obligated as Allah declares in holy Qur'an:

help ye one another in righteousness and piety, but help ye not one another in sin and rancor.¹¹³

The equal right is also found in the cooperative through the principle of "one member, one vote" at the Annual Meeting Members (RAT) as the highest consultative forum held at least one a year. RAT provides organizational association in the term of equality, inviting participation, determining right and obligation of the members as well as binding the

¹¹³ Al-maidah, verse 2.

responsibility of profit and loss.¹¹⁴ RAT is a manifestation of voluntary cooperation. The principle of voluntary is the principle of cooperative that is in accordance with Islamic principle. The cooperation deliberates the brotherhood which is the ideal character of muslim ummah. This indicates the conformity of mutual assistance (*ta'awun*), cooperated brotherhood, democratic, voluntary, open and kinship in cooperative.

In addition, the compliance of cooperative with Islamic teaching can be seen from the operating mechanism or operational pattern through a compensation system (profit or facility) received by members who adhere under regulation in accordance with their role and contribution upon cooperative. This is appropriate with re-compensation principle in Islam. Islam teaches mankind just to accept from what they done as Allah declares in holy Qur'an:

Then shall anyone who has done an atom's weight of good, see it and anyone who has done an atom's weight of evil, shall see it.¹¹⁵

It can be seen from the balance of effort (SHU) in cooperative, that the maximization of SHU is not its purpose and the utilization of some SHU is intended for the public interest. Thus, the exploitative efforts can be averted, emphasizing member service and giving attention to the public interest. This is appropriate with the value of togetherness and social justice purpose.¹¹⁶ To make social justice, Islam is against the hoarding (*ihlikar*) to some people and orders to spend wealth in the way of God i.e. through *zakah* institution, *infaq* and *shadaqa* that have multiplier effect towards the realization of social justice. Islam requires redistribution of wealth evenly, for instance the poor, the orphan, the beggar, also emphatically stated that the wealth or commodity should not be rotated among the rich.

The realization of social justice with this approach reflected the output of Islamic economic democracy system in harmony with the goals of cooperative as a tool of economic democratization. With this democratic practice, it can be seen that the cooperative management in reality is appropriate with the Islamic teaching. It indicates the conformity of cooperative operational pattern with Islamic teaching.

¹¹⁴Ahmad Dimiyati, "Islam and Cooperative, analytical study of the muslim role on the cooperative development", (Jakarta: Koperasi Jasa Indonesia, 1989), p. 72-73

¹¹⁵Al-zalzalah, verse 7-8.

¹¹⁶ibid., p. 75

3.4 Critical Analysis of BMT Legal Body

The current problem exists in the legality of BMT's body. In the reality, BMT does not have a clear legal framework. The draft bill of IMFIs which is expected to be a legal framework of BMT is also unclear. If the draft bill of IMFIs has already been validated, the existence of BMT can be regulated under the regulation of IMFIs. Keeping in the view, BMT will not be regarded as illegal financial institution, eventually several BMTs are operated by cooperative legal entities, i.e. by registering its operations to the department of cooperative and SMEs in the district or regency.

The existence of Shariah cooperative (KJKS) which has become one of the programs of the ministry of cooperative and SMEs which is the sole solution for the deadlock of BMT's legality. Thus, the present BMTs which have no legal entity are expected to convert into cooperative. The legal rule of BMT is an economic institution or un-bankable and informal IFIs.¹¹⁷ It is called informal because this financial institution was established by the Self Help Groups (SHGs). BMT can be established and developed by gradual legality process. Initially it was started with self-help groups by obtaining operational certificate/partnership from PINBUK. If it reaches the value of certain asset, it will be required to convert their legality into cooperative legal entity.

The operation of BMT was regulated under Self-help Groups legal body and cooperative, due to it was excluding as a formal financial institution which is prescribed under the Act No. 10 of 1998 about Banking law. According to the rule, that the party which are entitled to funding and financing are bank and rural bank (BPR), both of them are operated either in conventional or profit sharing principle. Nevertheless, if BMT with SHGs legal body or cooperative has been growing and fulfilling the requirements of rural bank, so that they can demand the government to establish BMT as Shariah Rural Bank under cooperative legal body or limited liability company. Accordingly, the Minister of cooperative and small medium enterprises (KUKM) issued the decision No: 91/Kep/M.KUKM/IX/2004, Article 24 stated:

The Shariah cooperative of financial service/ Islamic Finance Unit in addition to conduct financing activities or *tamwil*, also can conduct *maal* activities or funding and distribution of *zakah*, *infaq* and *sadaqa* funds including endowment.

¹¹⁷ Muhamad rizwan, "Management of *Bait al-Mal wa at-Tamwil (BMT)*", (Yogyakarta: UII Press,2005), p. 25

BMT is a non-bank Islamic financial institution and its regulation is not subject to the banking regulation, particularly Islamic banking whereas BMT should be set under the regulation of banking law, particularly Islamic banking law. The rules on capital, liquidity, health institution, the implementation of good corporate governance etc should be followed by BMT in order to develop its operational base and public confidence towards BMTs. With the increasing number of assets, BMT as cooperative legal body can change its status into Shariah rural bank (BPRS), from non-banking financial institution into Islamic bank and financial institution.

Under the provision of Article 4 paragraph (2) on Islamic banking law stated that the Islamic bank and Islamic business (UUS) May perform a social function in the form of *bait al-maal* institution, i.e. receiving *zakat*, *infaq*, *sadaqa*, *hibah* or social funds and allocate them to the institution of *zakat*. If BMT has become BPRS with its legal entity as limited liability company which is business oriented, it is still given the opportunity to perform its function as *bait al-maal*. But, the issue is whether the shareholder of BPRS either to remain his company on non-commercial business and conducting social function or just performing shariah business. According to the provision of the above mentioned article, we find the word "May" it means can be done or not.

Practically, BMT has a clear vision and mission and its focus is on the realization of the vision of professional agency. The mission of BMT is to develop the economic order and the structure of civil society and to make it prosperous according to shariah principles. Cooperative is a shariah compliant concept that can be applied to BMT. The relevance between cooperative and BMT can be seen from:

1. The similarity of the two institutions (cooperative and BMT) in historical background, that is struggling at the grassroot's interest as reaction to the economic system prevailing at that time. Cooperative was born as a tool and protest against the oppressive of capitalist system that could be an obstacle to the economic growth. Likewise, BMT emerged due to the existence of BMI and BPRS has not been able to reach the lower economic groups due to various constraints, namely provisions, complicated license as well as mobilization of funds have proven difficult to achieve.
2. With a reference to the both definition, it can be concluded that these two institutions contain two elements, namely the element of economy and interrelated social element.

This is the proof that these two institutions are not only engaged in the business but also in the social aspect.

3. In essence, these two institutions are striving for the welfare of member in particular and society as well in general through the management with ethical values and high moral. This quality distinguishes the two institutions with other economic business forms.
4. Both institutions are similar in objectivity e.g. striving for the welfare of members in particular and society in general and alleviating poverty of small community for the betterment of economy.
5. Based on the function and role of cooperative and BMT have two functions, namely social function and interrelated economic function which work like an engine of economic growth by developing and building the bottom layer of society's ability.
6. The concept of cooperative and BMT have to attempt three sectors, namely financial service sector, social sector and real sector.¹¹⁸ In addition, the both institutions must have supervisory board to control and supervise the two institutions. The aim of controlling and monitoring is to manage the activities appropriated with the expected goals and able to reduce the possibility of fraud and misappropriation of management by the board.

According to this analysis, there are many similarities between the cooperative and BMT concept, so that it supports in making the cooperative as a legal body of BMT. However, the legal body of BMT has to be evaluated, namely:

- a. It is necessary to have such mechanism to ensure the implementation of cooperative in accordance with the basic principle, because practically the deviation has occurred in its implementation. Cooperative has lost of its social function, it focuses merely on economic function. The principle of independence in cooperative body is not strongly implemented, it can be seen from the big intervention of government towards cooperative. The role of all parties particularly with regard to these institutions¹¹⁹ are needed to rectify the misunderstanding of cooperative concept which is occurred deviation. So that, it is needed a strong supervisory authority and its role should be

¹¹⁸Hertanto Widodo, "PAS (Islamic Accounting Guidelines), A practical guide to the operational of Bait al-Mal wa at-Tamwil", (Jakarta: Mizan, 1999), p. 84

¹¹⁹Government, Department of Cooperative, and all of governmental institutions.

improved to regulate the implementation of cooperative. Hence, the role of DEKOPIN¹²⁰ is very important.

- b. BMT as cooperative legal body has to change the interest system which is usually applied to the cooperative system into the Shariah principle system in Indonesia i.e. sharing profit such as *musharakah*, *mudharabah*, etc. So that, it can design the concept of Shariah cooperative institution.

4.4 The implementation of BMT's operational activities

The implementation of BMT's operational activities should be impartial between its role as Bait al-Mal and Bait at-Tamwil. The similarity between BMT and other business entities are having social and business field which are the urgent things in BMT. BMT should not only focus on business promotion (*tamwil*) but also concentrate in making good management as Bait al-Mal.

In the BMT's management framework, functionally it plays a role in some of the following: first, to assist Bait at-Tamwil in providing a cash for financing non-commercial allocation i.e. *Qard Hasan*. Second: providing a backup fund for debt-write off due to the bankruptcy of customer's business, he is regarded as *gharim*. Third, making the effort for social welfare enhancement such as scholarship, health care, donation for the public facilities and place of worship, also can assist the success of Bait at-Tamwil in promoting its funding products and distributed to the society. The distribution of generated funds in Bait al-Mal should not only allocated for the consumptive need of beneficiary of *zakah* (*Mustahik*) but also it can be managed and invested productively. It is worthy to note, that Bait al-Mal funds are derived from *zakah* fund and it is distributed for *mustahik* including the poor and needy.

The productive distribution pattern is generally developed by performing *Qard hasan* scheme. However, if the borrower is unable to repay the debt, the borrower cannot be sued for his inability because basically they are deserving the fund. The scheme of *qard hasan* performance is actually brilliant, it considers: first, the success of an institution is measured from its performance as the element of social security to raise up the welfare of a *mustahik* become a *muzaki*. If only the consumptive pattern is performed, it seems to be difficult to achieve the goals. Second, the capital which is returned by *mustahik* as the borrower does not

¹²⁰ DEKOPIN (Indonesian Cooperative Council) is the highest body in Indonesia representing cooperative organizations, with more than 130,000 cooperatives and 30 million individuals as members.

mean that he is no longer has a right to possess the capital. It can be reproductive by giving back the capital to them for the further business. If it does not, the result of *zakah* fund accumulation will re-distributed to other *mustahik*. So that, the expectation of *zakah* institution become the real partner of *mustahik* for their business development until the end of their status as *mustahik* of *zakah*.

Moreover, beside playing a prominent role as Bait al-Mal, it plays as Bait at-Tamwil i.e. conducting business activities based on the principle of Shariah. There are two main types of activities namely, raising fund (funding) and financing. These two functions have a strong relationship which is mainly associated with the plan of funding in order to avoid idle money. As in financing aims to avoid lack of funds or liquidity when it is needed. In funding activities, building the public trust is very important. BMT should keep the public trust by managing the well-kept funds and holding the shariah principle. The higher people put the trust in BMT the easier it can generate funds which are eventually distributed to the needy through financing mechanism.

Beside that, the activity of BMT in such financing is to distribute funds to the desperate people through a loan for their business capital by adhering the determined terms and conditions. It should be noted that from the various financing products which are often offered by BMT is *Murabahah* because it is easy application as well as low-risk factor. Nevertheless, BMT should optimize the distribution of fund through *Musharakah* and *Mudharabah* because these products are very useful in building and improving the poor's economy. If it only concentrates on profit-based i.e. *Murabahah*, the existence of BMT as IMFLs would be questioned again.

Legal Issues

There are some legal issues within the BMT's scope, which can potentially lead to the dispute and litigation or non-litigation settlement. Relating to the role of BMT, namely:

1. Improper management of *zakah* funds in BMT

The better and modern management of *zakah* fund is the obligation of BMT. It is considered that the fund which is collected by BMT is a mandate (*amanah*) from *muzakki* and to be contributed to the entitled people only. If BMT fails to manage it in a well manner and does not distribute it transparently, the given mandate becomes invalid. If the management of

BMT allegedly mismanages the *zakah* fund and the donor (*muzakki*) feels that the mandate given to the BMT is not properly implemented, it can bring a suit in the court for such unlawful act and demand that the use of *zakah* fund which is generated in BMT should be distributed to the beneficiaries.

2. Improper distribution of *zakah* funds

It is obligatory for BMT to use the *zakah* funds only on targeted areas at its best. If people observe that *zakah* funds is being misused and is given to the people who are not worthy of *zakah* fund, they can bring the case in court. The role of BMT is like *amil zakah* in collection and distribution of fund. Accordingly, it is duty of BMT to distribute the generated fund to the beneficiaries.

BMT is strictly bound to distribute the *zakah* in those eight categories that are specifically mentioned in the Quran. Not only the BMT will distribute the fund to fulfill the consumptive needs of the specified people but also invest the fund to obtain the profit, so that the beneficiaries may gradually convert from the receiver to the donors.

3. Non performing financing

Non performing financing is like a scourge that often faced by financial institution, including BMT. The customer always proposes reasons such as force majeure toward BMT to obtaining dispensation on restructuring of debts. If one party is unable to perform his part set forth in the contract due to some reason, so that the contract becomes frustrated. It includes: unable to fulfill the performance, able to perform but inappropriate with the contract and able to perform but not on time or delay.

Every executed contract can be breached within the period of the contract. Although the purpose of contract is aimed to fulfill the party's will, neither to seek out the unlawful manner nor to claim in the future. *Murabahah* contract is always used by BMT in financing activity through the obligation of customer to pay the installment whereby the profit and loss sharing determined in the contract.

4. The problem between BMT and other Financial Institution

The source of BMT's fund is not only derived from deposits but also by raising the loan from other financial institution. If BMT only relies on deposit fund, it would possibly face the

lack of funds and there might be a great difficulty for the BMT to generate the fund solely by this source.

Practically, BMT often takes loans from the Islamic bank or the institution of *zakah* fund. BAZIS Jakarta incorporation with the 27 BMTs distribute fund over 71 traditional markets. BMT acts as a partner in this activity. Its duty is to determine the traders who are entitled to have a loan from *zakah* fund. If the problem occurs in the future, it will possibly cause dispute between BMT and financial institution or social institution.

It can be explained by the following illustration, for example BMT raises fund from Islamic bank through *mudharabah* contract. BMT distributes it to the society through the various types of financing mechanism. During the maturity date of contract, BMT may face trouble in financing. Yet, BMT has an obligation to pay monthly installment at the certain due date according to the contract, but BMT is unable to fulfill its obligation, in that way the dispute arises between financial institutions.

5. The responsibility of the board in case of loss

In every Shariah business activity there is always risk of loss, in such a case BMT suffers loss in its business activity and the board should bear its loss. There is always a risk of loss especially in high-risk financing such as *mudharabah* and *musharakah* and if there is improper analysis before investing the funds in these type of business it will strongly impact the BMT. In the concept of conventional banking, if the bank issue a credit to the customer, the collateral must be asked for. In case, if the customer is unable to pay the whole amount of debt or installment within the specified period, the bank may use the collateral to offset its debt according to the prescribed regulation.

It is certainly different from the concept of guarantee in shariah contracts such as *mudharabah*. The guarantee in *mudharabah* is not guarantee¹²¹ of the debt but as the guarantor of honesty of the party to avoid violating the agreed terms and conditions of the contract. Therefore, if the party/entrepreneur suffers a loss and does not violate the contract, the guarantee will not be seized to result return of all financing. Thus, the guarantee is for non-infringement of term of contract by the entrepreneur.

¹²¹ The capital provider is permitted to obtain guarantees from the mudarib that are adequate and enforceable. This is circumscribed with a condition that the capital provider will not enforce these guarantees except in cases of misconduct, negligence or breach of contract on the part of mudarib. The guarantee should be refund in case of unintentionally (see: AAOIFI, Shariah Standard No. (13) Mudharabah).

Dispute Settlement

Following are the steps of dispute settlement relating to the above mentioned legal issues:

- a. In a case when BMT abuses *zakah* fund and distribute it amongst the people who do not fall in the specified categories or invest it in improper manner that is not prescribed to BMT, any person who has a legal interest in that fund can bring a suit in the court of law. Right of bringing the suit is invested in that person who paid its *zakah* to the BMT to distribute amongst the entitled persons. This right is also available to the person who considers himself entitled to take *zakah* but the same is not given to him in spite of approaching BMT. It is proposed that the claim of any other person should not be entertained.

Article 5 of Act No. 39 of 1999 on *zakah* management explained that the this institution is aimed at increasing the role of society in paying *zakah* as the command of religious institutions for the sake of social welfare and social justice.

Article 16 explained that the collection of *zakah* fund is allocated for the beneficiaries in accordance with the religious provisions and the utilization of collected *zakah* funds should be in accordance with the scale of the priority needs of beneficiaries and it can also be used for the productive business. It is Further described in the section that the eight specified groups (*asnaf*) are indigent, poor, collector (*amil*), *muallaf*, releasing prisoners (*riqab*), insolvent (*gharim*), Muslim soldiers (*shabilillah*), and way farers (*ibnu as-sabil*). This specification may encompasses the people who are economically weak such as orphans, old folks (the elderly), disable person, the students, *madrrasah* (Islamic institution), displaced person, refugees, the people who are under debt, and the victims of natural disaster.

- b. The dispute that is occurred due to trouble financing should be resolved according to the terms and conditions of the contract. If one of the parties does not perform his obligation and a loss is occurred due to that default, the party that is abiding by the terms and conditions of the contract is definitely entitled to compensation and can invoke the jurisdiction of a court of law for that purpose. However, the compensation can only be charged to the dishonest borrowers who break their promise. So the responsibility of the contract has three main elements, namely the honesty, the dishonesty can bring losses for the debtor, and the loss of creditor caused by (has a causal relationship with) the debtor's dishonesty.

- c. The dispute settlement between BMT and other financial institution basically refers to the engagement of the two underlying relationships. In this issue, the individual is not a subject matter of law but the legal body indeed. The board or the director of the limited liability company-unless the regulation decided otherwise are entitled to submit his complaint before the court. The contract which is made between BMT and other financial institution should be examined carefully. The obligation or duty of each party mentioned in the contract has the key role for resolution of dispute
- d. With reference to the settlement of the responsibility of the board in case of loss, first it should be reviewed their duty set forth in the statute and regulation. Under the provision of Article 31 of the cooperative law it is stated that the board is responsible for the cooperative management activities, ordinary or extraordinary general meeting. In Article 32 it is further an authorized manager will be appointed to manage the business, but it does not reduce the responsibilities of the board. It is reinforced by the provision of Article 34 that the board, either jointly or individually bears the losses which is suffered by the cooperative when the action is taken as a result of willful misconduct or negligence.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

Cooperative according to the shariah perspective can be returned to its nature as *muamalah* practice by using *ijtihad* method through *istinbat al-ahkam* (methodology of deducting legal rulings). It means every transaction is permissible in Islam unless it is specifically prohibited. We observe that the *riba* (interest) is involved in the agreement of cooperation that excludes it from the ambit of general permissibility. So to bring it in conformity with Islam, BMT has to remove the element of Riba from this contract or from the transactions that have been done under this contract and the term cooperative might be used by BMT as a legal body.

The prospect and development of BMT as one of IFIs it is believed to have opportunities to grow as compared to other financial institutions that operate conventionally due to the following reasons:

1. IFIs are performing according to the principle of justice, fair dealing and rationality, where the profit gained from the investment of fund is shared to the customer according to the agreed upon ratio. By this pattern, the IFIs are certainly free of negative spread as occurred in conventional institution.
2. IFIs aimed at the same lines as the government's program, namely the society's economic empowerment, so there is a big opportunity to achieve their goals by mutual cooperation. As it is known that, the government is trying to develop the democratic economy through profit sharing, working capital by financing small and micro enterprises. Of course it is a big chance for BMT to develop a partnership with government.
3. As long as the borrowers and the users of fund are adhering the profit sharing system, the economic activity could be consistently supervised by Shariah. The IFIs do not recognize the pattern of exploitation which is performed by the owner of the fund against the users of fund as a result of higher profit ratio which are applicable on the conventional system.
4. Thus, it can be understood that BMT has a pretty big chance to play a role in economic development based on democratic economy. This due to BMT was founded on the basis of Islamic principle which gives the donors and beneficiaries a feeling of satisfaction.
5. Cooperative system is accepted according to deduction of shariah (*istinbath al-ahkam*) through ijthihad method. It indicates the conformity of mutual assistance (*ta'awun*). So, the operation of BMT under cooperative based is accepted in islam.
6. The management of BMT as bait al-mal still remain to be improved, because the donor (*muzakki*) feels that the mandate given to the BMT is not properly implemented.
7. *Zakah* is the important tool to reduce poverty. Therefore, it needs people's awareness to pay *zakah* through *zakah* institution such as BMT and so forth.
8. From the above analysis on *murabahah* contract in BMT Tasikmalaya, it can be concluded that the determination of the margin level does not refer to the prevailing interest rate.
9. The practice of *mudharabah* in BMT Tasikmalaya still not refers to the principle of shariah, the BMT does not give a fixed monthly profit transparency as commonly applicable in conventional bank.

10. The primary survey (Annexure II and III) conducted in respect of the employees of 8 BMTs transpires that BMTs were disbursing funds to rural poor segments for both agricultural and commercial purposes catering to the needs of micro enterprises and SMEs.

Recommendations

Based on the result of research conducted by the researcher on the development of BMT in Indonesia particularly in Tasikmalaya, following recommendations are proposed for the development and operation of BMT:

1. BMT should concentrate on managing small loans for micro and small enterprises (below Rp. 5.000.000,-) as compare to rural bank (BPRS) provides a small loan Rp. 3.500.000 for working capital. For the customer who requires large sum of money should be suggested to get financing from the banks.
2. BMT should organize training business program/entrepreneurship periodically for their members (e.g. through lectures and meetings). These activities will help BMT to increase the social capital which is required for the further development of BMT in Tasikmalaya.
3. The ministry of cooperative should initiate the activities i.e. designing and funding the programs of ability improvement according to its institutional character and social goals.
4. The efforts to inspire the society in a way that they should creative and innovative on the problem resolution which is still perceived so weak. Creating a prestigious award that can increase a pride and social awareness of social business.
5. The ministry of cooperative should compile a locality guide containing the information on existing BMTs and highlighting various business strategies, products and BMT's services. Electronic version (website) also can be considered as the improvement in information access.
6. The department of cooperative should seriously play biggest vital role in the development of society by providing opportunities to the social enterprises. By making such training to the people on how to make good management, trustworthy and skilful accountant.

7. BMT associations which are located in the region should be reformed. These groups have to share the information and develop the standard operating procedures as the first step to become an institution that can regulate their own functioning.
8. BMTs should utilize a local knowledge and social capital to expand its business.
9. BMTs are supposed to guarantee the safety fund members, but it should keep in mind that these social enterprises need business friendly policies from the government side. Regulating BMT with existing banking law will likely to destroy the main function of BMTs.
10. In the short term, taking BMT into the cooperative law is more feasible. The process of amendment should be done by consultation with the current active BMT.
11. In the long term, it should be made a special regulation and comprehensive that is designed to meet the needs of BMT (micro-finance, business training, and management of *zakah* through the stakeholder consultation).
12. BMT should not take a fee from the customer in respect of *Hawalah* contract. Because this practice is contrary to the principle of *Hawalah* as *tabarru'* contract.
13. The minimum amount of '*urbun*' in BMT Al-Hidayah is still high (40%). So that, BMT Al-Hidayah should decrease the amount of '*urbun*' into 20% as compared to BMT Mitra Kita '*urbun*' is 20%. According to the Islamic principle that '*urbun*' is permissible as long as its amount does not burden the customer.
14. The product of *Qardh hasan* is still rarely used as a superior product in BMT Tasikmalaya, mostly *murabahah* product is applicable there. Apparently, *Qardh hasan* is one of the major tools of poverty alleviation. So that, the BMT should not merely conduct profit-based, however, BMT should provide grant fund and allocate it for *qardh hasan* fund. Therefore, the vision and mission of BMT as the engine of economic growth can be implemented.

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Questionnaire

Profile of BMT

1	Name of BMT	
2	Address	
3	Date of establishment	
4	Date of Operation	
5	Type of Institution	a). Foundation b). Cooperative c). PT or CV d). Other

PROCESS OF FINANCIAL REPORTS AND ASPECTS OF MANAGEMENT

Q 1.1	What kind of financial report is available in BMT? (if possible, give the recent financial report)	a). Balance b). Income statement c). Cash flows statement d). Statement of changes in capital e). Notes of the financial statement f). Non Halal report g). Zakah Funds report h). Profit distribution report (the answer can be more than one)
Q1.2	What kind of report does the BMT give to the customers and the public?	a). Balance b). Income statement c). Cash flows statement d). Statement of changes in capital e). Notes of the financial statement f). Non Halal report g). Zakah Funds report h). Profit distribution report (the answer can be more than one)
Q1.3	Are the clear and the good Standard operation Procedure (SOP) available for financial administrators?	a). Yes b). No
Q1.4	Does the BMT has its own accounting unit that separate from other section?	a). Yes b). No

Q1.5	How many administrators are managing the financial of BMT ?
Q1.6	Does BMT has internal auditor?	a). Yes b). No
Q1.7	Whether the financial statements of BMT have been audited by public accountant or an external auditor?	a). Yes b). No
Q1.8	Does BMT has Shariah supervisory board?	a). Yes b). No
Q1.9	How is the role of shariah supervisory board?	a). very important b). Important c). Not important
Q1.10	How often the shariah supervisory board is involved in making decision?	a). Always b). involved in serious issue c). seldom d). Never
Q1.12	Does BMT always inform the management of funds to the customer?	a). Yes b). No
Q1.13	How many times does BMT inform?	a). every month b). 3 to 4 months c). 6 months d). once a year
Q1.14	What kind of media is used to inform the above information?	a). Bulletin board b). Television c). internet d). Letter/report to muzaki e). Others
Q1.15	What are the constraints faced by BMT?	a). Lack of clear standards and guidelines b). Lack of human resources c). higher cost of professional financial management d). Lack of public awareness of saving in BMT (The answer can be more than one)

DISTRIBUTION OF FUNDS

(Murabahah, Musyarakah, Mudharabah, Qardh)

1	How many percent the average of administrative cost of the total received financing?	a). 1% - 3% b). 4% - 5% c). Above 5%
2	In murabahah contract, how to calculate profit margin?	a). Bargaining-based with customers b). Determined by the policy of

		BMT management c). Others
3	If in murabahah contract the BMT get discount from supplier, which of the following is cost-based pricing?	a). Price after percent off b). Price before percent off c). Others
4	Which of the following murabah practice is often executed?	a). The goods is purchased by BMT its self b). Murabahah by representing the purchase of goods to customer c). others.....
5	If BMT represent the purchasing goods to customer, does BMT always ask for receipt?	a). Always b). Seldom c). Never
6	If the fund is still remaining, does it refund to the customer?	a). Always b). Seldom c). Never
7	Does BMT obligate the customer to pay <i>U'rbun</i> ? If yes, how many percent ?	a). Always (minimum.....%) b). Seldom
8	What is the penalty of the defaulter given by BMT even he is able to pay?	a). Charge/Fine b). Simple-warning c). Others
9	What does the BMT do if the customer terminate the contract ?	a). Fine b). Extra fee charge in order to pay off the financing c). Profit margin cutoff based on the agreement d). Others
10	If the BMT provide profit margin cutoff, does it include in the contract?	a). Yes b). No
11	In which financial report does BMT allocate the charge?	a). Non halal income b). The main non-operating income c). Qardh hasan fund d). Others
12	Who will bear the loss if the goods is damage before handing it over to the buyer ?	a). Seller b). Buyer c). Supplier
13	Does BMT show the invoice to the customer ?	a). Yes b). No
14	What kind of collateral does BMT require on murabahah contract?	a). The purchased goods b). Other goods with the same value c). Other goods with the higher value
15	If the payment of murabahah is being paid by instalment or deferred, how is it calculated?	a). Profit should be calculated evenly based on the maturity of

		the contract. b). Profit is calculated at the first payment and is calculated evenly based on the maturity of contract c). Profit is calculated at the final instalment d). Other
16	Does BMT still obligate the customer to pay a tax on the transaction?	a). Yes b). No
17	Does BMT allow the customer to to sell the purchased goods to other customer?	a). Yes b). No
18	Does BMT refund U'rbun to the customer if he cancels the contract?	a). Yes b). No
19	How long the average of murabahah financing?	a). 3 – 6 months b). 6 – 12 months c). 12 – 36 months
20	How much the average of murabahah financing?	a). Below Rp. 500.000,- b). Rp 500.000,- to Rp Rp. 1.000.000,- c). Rp 1.000.000,- to Rp. 5.000.000,- d). Above Rp. 5.000.000,-
21	Who are the customers of murabahah financing?	a). Civil servant b). Small entrepreneur c). Private employee d). Other
22	The average type of goods on murabahah financing (sort by the number of customers)	a). Movable property (vehicles) (.....) b). Electronics (.....) c). Houses (.....) d). Family needs (school, etc) (.....) e). Others
23	Does BMT use Mudharabah mode of financing?	a). Yes b). No
	If Yes, fill the point no. 24 – 39	
24	Does BMT use Mudharabah mode of financing to mudarib as debt or working capital?	a). Debt b). Working capital (investment)
25	Does BMT require the minimum time of business at least 3 years of actual operation?	a). Always b). Never c). Seldom
26	Does BMT require the collateral?	a). Yes b). No
27	How long the average time of Mudharabah	a). 3 months

	financing?	b). 6 – 12 months c). 12 – 36 months
28	How much the average amount of mudharabah financing?	a). Below Rp. 500.000,- b). Rp 500.000,- to Rp Rp 1.000.000,- c). Rp 1.000.000,- to Rp 5.000.000,- d). Above Rp 5.000.000,-
29	Types of business on mudharabah financing (sort by the number of customers)	a). Commerce (.....) b). Agriculture (.....) c). Husbandry (.....) d). SMEs (.....) e). Others (.....)
30	Profit sharing system on Mudharabah contract?	a). Revenue Sharing b). Profit Sharing
31	How does the BMT know the actual profit and loss?	a). The actual management report of <i>Mudharib</i> b). Calculation result of BMT c). Other.....
32	Does BMT use Musyarakah mode financing?	a). Yes b). No
	If yes, fill the point no. 32 – 36	
33	From where does BMT generate Qarh hasan fund ? (the answer can be more than one)	a). Customer's Charge b). Non halal income c). Zakah, Infaq, Sadaqa d). Other.....
34	Does BMT require the administrative fee?	a). Yes b). No
35	If yes, where does BMT allocate the charge	a). Qardh hasan fund b). Non halal fund c). Non-operating income
34	Does BMT require the collateral?	a). Yes b). No
36	How if the customer is unable to repay the loan?	a). Removing the debt of qardh hasan fund b). Extending the time of payment
37	How long the average period of Qardh hasan?	a). 3 – 6 months b). 6 – 12 months c). 12 –36 months
38	How much the average amount of qardh hasan financing?	a). Below Rp 500.000,- b). Rp 500.000,- s/d Rp Rp 750.000,- c). Rp 750.000,- s/d Rp 1.000.000,- d). Above Rp 1.000.000,-

39	Types of customer's needs (sort by the number of customers)	a). Foods (.....) b). Education (.....) c). Business (.....) d). Other (.....)
40	What is the impact of BMT on poverty alleviation, particularly for the member of BMT?	a). Decrease (....%) b). Stable (....%) c). Increase (....%) d). Other
	Does BMT use other modes of financing?	a). yes b). No
	If yes, mention it please !

PROFIT DISTRIBUTION

1	What is the profit distribution system of BMT?	a). Accrual basis system b). Cash Basis c). Not specified
2	Has the profit distribution system been agreed in the contract?	a). Yes b). No
3	What is the profit distribution principle of BMT?	a). Revenue sharing b). Profit sharing c). Not specified
4	How many percent does BMT take for the profit?	a). Below 10% b). 10% - 20% c). Above 20%
5	Can the profit distribution system of BMT attract the new member?	a). Yes b). No
6	Does BMT inform the report of profit distribution to the customer?	a). Always (periodically) b). Seldom c). Never
7	Does BMT find any difficulties on profit distribution system?	a). Yes b). No

Results of the BMTs interviewed

- 100% respondents answered that BMT was maintaining balance report, income statement, cash flow statement and statement of changes in capital. Whereas, none of the BMTs were preparing notes of the financial statement, non halal report, *zakah* funds report, and profit distribution report.
- 100% respondents informed that financial administrator of BMTs were clear and good standard operation procedure, also BMTs had their own accounting unit that separate from other section.
- From 8 BMTs 100% respondents informed that 16 administrators were managing the financial administration of BMT.
- 100% respondents informed that none of BMTs were having internal Auditor.
- 100% respondents informed that BMTs had Shariah supervisory board (SSB) and role of SSB was very important.
- 40% respondents informed that the SSB was always getting involved in making decision, whereas 60% respondents informed that SSB was involved only in serious issue.
- 100% respondents informed that BMTs were always informing the management of funds to customers.
- 10% respondents informed that BMTs were informing the management of funds to customers every 6 months, whereas, 90% of them informed that BMTs were informing the management of funds once a year. None of BMTs were informing the management of funds every month or within 3 to 4 months.
- 36% respondents informed that BMTs were using bulletin board as media to deliver informations or reports, whereas 40% of them informed that BMTs were using television as media to deliver informations or reports, while 24% respondents informed that BMTs were using internet as media to inform reports. None of BMTs were using letter or report to *muzakki*.
- 100% respondents informed that lack of human resources were the constraints of BMTs, while lack of clear standards and guidelines, higher cost of professional financial management, lack of public awareness of saving in BMT were not the constraints of BMTs.

- 100% respondents informed that the percentage of the average administrative cost of BMTs was up to 3%, while none of BMTs were earning above 3% of the administrative cost.
- In Murabahah contract, 100% respondents informed that the profit margin calculation of BMTs was determined by the policy of BMT management, whereas none of BMT's profit margins were calculated by bargaining-based with customers.
- 100% respondents informed that BMTs were selling the commodity with a price after the percent off discount was applied, whereas none of BMTs were selling the commodity before percent off discount was applied.
- 100% respondents informed that in Murabahah the purchase of goods was conducted by the customers and BMTs were always asking the receipt from them.
- 80% respondents informed that BMTs were always refunding the remaining fund to the customers, while 20% respondents informed that BMTs were keeping the remaining fund.
- 80% respondents informed that the customers were requested to pay 20% '*urbun*', while 20% respondents informed that BMTs were seldom to request the customers to pay.
- 100% respondents informed that BMTs were giving simple warning penalty for the defaulter.
- 70% respondents informed that BMTs were giving a fine for the customers who terminated the contract, while 30% respondents informed that BMTs were giving penalty by cutting off profit margin.
- 100% respondents informed that BMTs were allocating the charge for *qardh hasan* fund, whereas none of BMTs were allocating the charge for non halal income and non-operating income.
- 100% respondents informed that the loss was borne by the supplier in case of commodity damage, whereas none of BMTs were handing over the loss to the buyer.
- 100% respondents informed that BMTs were showing the invoice to customers.
- 100% respondents informed that BMTs were requiring the collateral with the same value of goods, whereas none of BMTs were requiring the collateral with the higher value of goods.

- 100% respondents informed that in Murabahah the profit was calculated evenly based on maturity of the contract if the payment had been made by installment or deferred. Whereas none of BMTs were calculating the profit at the first and the final payment.
- 100% respondents informed that none of BMTs were obligating the customer to pay a tax on the transaction and were not allowing the commodity for sell to other customers.
- 100% respondents informed that BMTs were refund '*Urbun* in case of cancellation of the contract.
- 54% respondents informed that the duration of Murabahah financing in BMTs was 3 to 6 months, while 46% of them informed that the duration was 6 to 12 months. None of BMTs were providing the duration of Murabahah financing around 12 to 36 months.
- 54% respondents informed that the average amount of Murabahah financing in BMTs was below Rp. 500.000,-, while 46% of them informed that the average amount of Murabahah financing was Rp. 500.000,- to Rp. 1.000.000,- . None of BMTs were providing Murabahah financing above Rp. 1.000.000,-
- 100% respondents informed that mostly the customers of BMTs were small entrepreneur, whereas none of customers of BMTs were civil servant, private employee and so forth.
- 20% respondents informed that movable property such as vehicles were the need of customers on murabahah financing, while 14% respondents informed that the electronics were the need of customers, 10% of them informed that the houses were the need of customers, and 56% of them informed that the most priority of BMT's customers were family needs such as school and so forth.
- 80% respondents informed that BMTs were using Mudharabah mode of financing, whereas 20% respondents informed that none of BMTs were using Mudharabah financing.
- 100% respondents informed that BMTs were using Mudharabah mode of financing to mudharib as working capital (investment), whereas none of BMTs were using that mode as debt.
- 100% respondents informed that BMTs were seldom requiring the minimum time of business at least 3 years operation.

- 30% respondents informed that the average time of Mudharabah financing was 3 months, whereas 70% respondents informed that the duration of Mudharabah financing was 6 to 12 months.
- 70% respondents informed that the average amount of Mudharabah financing was below Rp. 500.000.-, whereas 30% respondents informed that the average amount of mudharabah financing was Rp. 500.000,- to Rp. 1.000.000,- and none of BMTs were providing amount of financing above Rp. 1.000.000,-
- 20% respondents informed that (10%) of Mudharabah financing was in commerce, 24% respondents informed that (20%) of Mudharabah financing was in agriculture, 56% respondents informed that the most priority of mudharabah financing was in SMEs.
- 60% respondents informed that BMTs were performing revenue sharing system to share their profit, whereas 20% respondents informed that profit sharing system was used by BMTs to share their profit.
- 60% respondents informed that BMTs were performing Musyarakah mode financing, whereas 40% respondents informed that none of BMTs were performing this mode.
- 36% respondents informed that the average period of Qardh Hasan financing was 3 to 6 months, whereas 24% respondents informed that the average of it was 6 to 12 months. None of BMTs were providing the average period of qardh hasan from 12 to 36 months
- 36% respondents informed that the amount of Qardh Hasan financing was below Rp. 500.000.- whereas 24% respondents informed that the the amount of qardh hasan financing was around Rp. 500.000,- to Rp. 750.000,-
- 48% respondents informed that there were 200 customers allocated Qardh Hasan fund for education, whereas 52% respondents informed that there were 300 customers allocated qardh hasan funds for business.
- 90% respondents informed that the impact of BMTs could decrease poverty level, particularly for the members, whereas 20% respondents informed that the level of poverty was stable.

Results based on interview of BMT management

1. What are the products of BMT?

Answer: Every BMTs had their own products according to the market condition. Actually, BMTs had two contracts: business and social. The Business consists of: sell contract, ijarah and so forth also services.

2. What is the impact of BMT on poverty alleviation towards the customers in particular?

Answer: Actually, the revenue of the members or customers were increasing, the family members could take educational level, saving money in BMTs and so forth.

3. Currently, how many groups of BMT exist?

Answer: there were PINBUK, ABSINDO, INKOPSYAH, PBMT, MICROFIN.

4. Where does the BMT obtain the fund from?

Answer: the funds were generated from members, banks and other third parties.

5. What does the BMT do in case of defaulter?

Answer: It depends on their cases, the principle of IMFIs was always applicable and for the poorest they would be included in bait al-mal.

6. What is the strategy of BMT to manage risks?

Answer: The risk management was similar to IMFIs, by performing a good analysis, collateral and so forth.

7. What is the impact for BMT's activities since 2012 the government of Tasikmalaya accelerated the distribution of fund?

Answer: We always struggle for the better management and activities although the government accelerated the distribution of funds.

8. How much the income or the asset of BMT in Tasikmalaya?

Answer: (The data has been mentioned in chapter one. See chapter one for further details)

9. What is the impact of BMT's financing towards the development of SMEs?

Answer: According to the Central Bureau of Statistics, Indonesia has had more than 37 million SME accounts, which contributed 60% to the Gross National Product (GNP) and constituted more than 95% of the total number of enterprises in the country.

Summary of results of the BMTs interviewed

Here is a summary of the 50 respondents of 8 BMTs in Tasikmalaya. The respondents also include managers and employees.

TOPICS	RESPONDENT PERCENTAGES
<p>MANAGEMENT</p> <ul style="list-style-type: none"> • Maintaining balance report, income statement, cash flow statement and statement of changes in capital • Clear and good standard operation procedure • Informing the management of funds to BMT's customers • The administrative cost of BMTs is up to 3% • Selling the commodity to the customers with a price after the percent off discount is applied • Murabahah to the purchase of goods is conducted by the customers • The charge is allocated for Qardh hasan fund • The loss is borne by the supplier in case of commodity damage • BMTs are requiring the collateral with the same value of goods • BMTs are refund 'urbun in case of cancellation of contract • The customers of BMTs are small entrepreneur • BMTs are using mudharabah mode of financing as working capital • The shariah supervisory board is available in BMTs 	<p>100%</p>
<ul style="list-style-type: none"> • Report of management of funds (6 months) – (a year) • BMTs refund the remaining fund • Urbun requirement • BMTs are giving a fine to the defaulter • Duration of Murabahah and Qardh hasan financing (3-6 months) – (6-12 months) • Amount of Murabahah and Mudharabah financing (Rp. 500.000,-) – (Rp. 1.000.000,-) • Duration of Mudharabah financing (3 months) – (6-12 months) • Type of Mudharabah financing - (10% in commerce) <li style="padding-left: 20px;">- (20% in agriculture) <li style="padding-left: 20px;">- (70% in SMEs) • Qardh hasan allocation - (200 customers for education) <li style="padding-left: 20px;">- (300 customers for businesses) 	<p>(10%) – (90%)</p> <p>(80%) – (20%)</p> <p>(80%) – (20%)</p> <p>(70%) – (30%)</p> <p>(54%) – (46%)</p> <p>(54%) – (46%)</p> <p>(30%) – (70%)</p> <p>(20%)</p> <p>(24%)</p> <p>(56%)</p> <p>(48%)</p> <p>(52%)</p>