

A BRIEF ABOUT THE DEVELOPMENT OF ISLAMIC MICROFINANCE IN INDONESIA

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Abstrack

Microfinance sectors in Indonesia had continuously developed and rapidly increased from 1945 to 2020. Particularly, after the declaration of the Indonesian year of microfinance in 2006 by President Susilo Bambang Yudoyono (SBY), the number of institutions, funds approved and funds' size had also increased, including the Islamic microfinance sectors, such as Bayt al-Mal wa al-Tamwil (BMT) institutions. In 2020, the Ministry of Cooperatives and SMEs in collaboration with Pusat Inkubasi Bisnis Usaha Kecil (PINBUK) or Center for Micro Enterprises Incubation, registered 175,102 microfinance institutions all over Indonesia which brought total assets of 77,514,341.36 million Rupiahs. This reflected the strong demand of Indonesian people to uphold the economic and financial system as one of the important structures of the country's development. Thus, this study will focus the development of microfinance in Indonesia and how the Islamic microfinance such BMT as an Islamic microfinance institution, established by Muslim society in Indonesia takes initiatives to help micro entrepreneurs as a strategy for eradicating rural poverty especially in villages or traditional markets in Indonesia.

Keyword : *A Brief, Development Of Islamic, Microfinance In Indonesia*

Introduction

No one knows for sure when the microfinance concept of business in the world began. However, some economists said that the philosophy or concept of microfinance is not new. Micro savings, credit groups and micro insurance activities have been operating for centuries in several countries under many different terms, such as “*Koperasi*” in

Indonesia, Malaysia and Brunei Darussalam; “*Tontines*” in the West of Africa and “*Pasanaku*” in Bolivia as well as numerous micro savings groups, entrepreneurs and burial societies all over the world.¹ According to Islamic historical civilization (*tarikh al-hadarah al-Islamiyyah*), Islamic civilization

¹ (Consultative Group to Assist the Poor [CGAP], 2004).

dealt with the financial practices including micro credit (lending and borrowing of money), money exchange and such, had been actually practiced in early era of Islam. It is claimed that, because usury (*riba*) had been widely practiced among business people who were borrowing and or lending money at the time before Islam, the Islamic tenet then came to state clearly that usury (*riba*) is prohibited as it is said in the Qur'an as follows:²

Those who devour usury (*riba*) will not stand except as stands one whom The Satan by his touch Has driven to madness. That is because they say: "Trade is like usury", but Allah hath permitted trade and forbidden usury.³

Furthermore, University of Gadjah Mada [UGM] Research Team (1984),⁴ reported that the origin and the development of microfinance concept in the world have essentially driven by the issues of poverty based on the capitalistic economic system. The existence of microfinance system in a country is very important

tool to break the wall of poverty as a result of the capitalistic economic system. Therefore, the first microfinance organization which was born in England (1844) to solve the problem of daily needs of its members by way of togetherness based on the basic principles of justice, trust, unity and responsibility, known as "Rochdale Principles". Within a short time, in France some microfinance institutions have also been established, which engaged in the productions.⁵

According to another historian (Seibel, 2003),⁶ the birth of microfinance in Europe dates back to tremendous increase in poverty since the 16th century. One of the earlier and classic longer lived microcredit organization has provided small amounts of loan for the rural poor and privileged with no collateral security, using peer monitoring to enforce the repayment, weekly installments, initially interest free loans and donated resources. This concept called "Kreditkassen" or "Irish

²Muhammad Akhyar Adnan (1996), *An Investigating of Accounting Concept and Practices in Islamic Banks: The Case Study of Bank Islam Malaysia Berhad and Bank Mu'amalat Indonesia*. 38

³ Al-Baqarah: 275

⁴ University of Gadjah Mada [UGM] Research Team, *Cooperative: An Introduction*, (Yogyakarta: Regional Ministry of Cooperatives of Indonesia, 1984), 11.

⁵Rochdale Principles of cooperative namely: Open and voluntary membership, democratic control, interest on share capital limited to 6%, distribution of surplus to members in proportion to their transactions, cash trading, education and training for members, political and religious neutrality, charitable

⁶ Hans Dieter Seibel, "History Matters in Microfinance", *International Journal of Microfinance and Business Development Germany*, vol. 14, no. 2 (June 2003): 10-11.

loan funds”, was initiated in the early 1720s by Jonathan Swift. Swift’s concept then grew slowly until he died, but by the 1840s this concept had become widespread where there were about 300 funds all over Ireland providing small loans or credits.

In Europe, furthermore, various types of larger, formal and non-formal savings and credit institutions were organized primarily among the rural and urban poor in the 1847s. These institutions, then, were known as “Darlehnsvereine” or “Credit Associations”, created rural savings and credit cooperatives with the help of contributions of some wealthy people. This concept was developed by *Friedrich Wilhelm Raiffeisen* and his followers in Germany. Their altruistic action was motivated by the concern to assist the rural population, to break out of their dependence on money lenders besides improving their social and economic welfare. Beginning from 1870, this concept has expanded rapidly over a large sector in German States and spread to other countries in Europe, North America and Asia, including Indonesia.⁷

As we have alluded before that, Indonesia has a long and

earlier differentiated microfinance sector among developing countries in Asia. This sector in Indonesia has distribution of assets in the event of dissolution. See, *Handbook on Cooperatives for Use of Workers’ Organizations* (Geneva: ILO, 2007), 13. evolved more than one century ago, such as *Schulze-Delitzsch* (1896), *Budi Utomo* Foundation (1908), *Shirkah al-^cInan* (1918), *Volkscredit Wezen* (1920) and *Serikat Dagang Islam* (1927).⁸

Masngudi (1990) has discussed broadly the historical origin and development of microfinance sectors in Indonesia. He has found in his study that the movement of microfinance sectors in Indonesia, actually, was born in the late nineteenth century (1896). At that time, Indonesia was under the Dutch colonization. Therefore, the microfinance climate was not favorable for the country and its people. After the Indonesian independence in 1945, Mohammad Hatta, was known as “The pioneer of Indonesian microfinance”, put microfinance formula in the Indonesian Law of Constitution or *Undang-Undang Dasar (UUD) 1945*, Article (33).⁹

⁸See, Hans Dieter Seibel, *History Matters in Microfinance*, 2003, 8.

⁹As reported before in the introductory chapter by Masngudi that *Schulze-Delitzsch* (1896) was further developed by *De Wolf Van Westerrode*, the Assistant of Dutch Resident in Banyumas Region in Central Java,

⁷ Masngudi, *History of Cooperatives in Indonesia*, 1990, 3. *Journal of Microfinance and Business Development Germany*, vol. 14, no. 2 (June 2003): 10-11.

Since that time, the growth of microfinance sectors in Indonesia had better growth and rapid development. The emergence of microfinance in Indonesia is a reflection of a strong desire and commitment of the Indonesian people in promoting financial products and services in the micro scales. Likewise, there was

Indonesia. It has been reported that when he visited Germany, he studied the operation of the Volksbank Raiffeisen for micro-savings and the peasantry. He studied also Schulze-Delitzsch Cooperative for micro-savings and for micro-credits in the city. As a result, he worked for development of microfinance system in this region which was pioneered by chief of Region, i.e. Raden Aria Wiriatmadja before him. As for *Shirkah al-'Inan*, it was founded in early 1918s by Kyai Haji Hashim Asy'ari, the pioneer of Nahdatul Ulama' (NU) Organization and founder of Islamic boarding school (Pesantren) Tebuireng Jombang, East Java. This institution consisted of 45 members, led by him and assisted by the Kyai Haji Mansor Bisri and Sheikh Abdul Wahhab. Subsequently, Budi Utomo Foundation was founded by Boedi Oetomo in 1908, aimed to overcome the household needs. Likewise, Serikat Dagang Islam or Islamic Trader Union was founded in 1911 by Haji Samanhudi to engage the daily needs of Muslim people by involving them into entrepreneurship sectors. Lastly, *Volkscredit Wezen (Bank Rakyat)* was founded in 1927 by the Dutch colonial government as for their political strategy to take care of people's concern. See, Masngudi, *History of Cooperatives in Indonesia*, (Jakarta: Ministry of Cooperatives and SMEs of Indonesia, 1990), 9-10.

government has committed in establishing and advocating various types of micro finance institutions and disseminating knowledge about it among the people of Indonesia.¹⁰

According to Masngudi (1990),¹¹ the attitudes of different governments about the historical growth and development of microfinance sectors in Indonesia before and after Dutch and Japanese colonizations can be classified as follows:

- a. Dutch colonial government was passive.
- b. Japanese colonial government was active, if it brought the benefits for them; and was passive, if it worked conversely. As a result, the microfinance's growth and development were destroyed.
- c. The government of Indonesia is active and boost an opportunities for the people and encouraged microentrepreneurs, including Islamic microfinance institutions.

Table 1.1 below summarizes the development of microfinance rate in the final years of Dutch and Japanese colonization and in early Indonesian independence (from 1930 to 1959); whereas record numbers of microfinance development in between the year 1941 to 1955

¹⁰ Ibid.,5

¹¹ Ibid

were not available. Table 1.2 on page no. 6 summarize it the development from independence of Indonesia in 1945 to 2010; whereas record numbers of microfinance

development in between the year 1960 to 1984 and the year 1990 to 1992 were not provided by the Ministry of Cooperatives and SMEs of Indonesia.

Table 1.1

Indonesian Microfinance's Development during the Years 1930-1959

Types of Microfinance	Year	Number of MFIs	Members of MFIs	Reserved Deposits (IDR)
All types of microcredits	1930-39	574	52,555	850,671
Rural microfinance type	1940	53	2,072	2
	1956	4,085	969,523	55,185
	1957	4,017	940,134	64,768
	1958	4,750	1,108,944	80,355
	1959	4,085	1,329,450	102,072
Urban microfinance type	1940	478	41,308	256
	1956	4,545	624,489	102,299
	1957	4,269	622,049	121,200
	1958	5,526	689,220	171,1804
	1959	6,095	756,634	223,018
Micro-savings (rice-barn) type	1940	19	1,291	1
	1956	637	53,747	1,213
	1957	491	62,258	1,421
	1958	531	56,306	2,530
	1959	1,450	153,536	28,881
Microproduct (production) type	1940	43	1,973	11
	1956	1,349	144,524	112,640

	1957	1,213	111,815	152,903
	1958	2,048	168,321	280,167
	1959	1,216	139,063	388,552
Microcredits (basic needs) type	1940	23	640	3
	1956	840	124,811	18,781
	1957	625	85,371	13,031
	1958	805	113,067	19,440
	1959	1,935	244,137	47,391
Other types of microfinance	1940	8	90	3
	1956	300	124,811	18,781
	1957	1,098	85,371	13,031
	1958	270	113,067	19,440
	1959	272	244,137	47,391

Note. The numbers of deposits are reserved in thousand Indonesian Rupiah (IDR 1.000).Adapted from Masngudi (1990), History of Cooperatives in Indonesia,18-19.

It is notable from the table 1.1 above that, the existence of microfinance sectors in Indonesia has experienced continuous growth and developed from 1930 to year 1959. The numbers of institutions, memberships and reserve deposits had also increased, although that time it was supervised by the politic domination of Dutch colonialism. In 1930 micro finance sectors began with very minimum quantity, such as for all microfinance types there were only 39 institutions, 7,848 members and 10,129,600 millions Rupiahs of reserved deposits. However, in the year 1959 rural microfinance had increased to 4,085 institutions,

1,329,450 memberships and 102,072.000 Rupiahs of reserved deposits.

The table 1.2 shows that microfinance sectors in Indonesia had continuously developed and rapidly increased from 1945 to 2010. Particularly, after the declaration of the Indonesian year of microfinance in 2006 by President Susilo Bambang Yudoyono (SBY), the number of institutions, funds approved and funds' size had also increased, including the Islamic microfinance sectors, such as BMT institutions. In 2010, the Ministry of Cooperatives and SMEs in collaboration with PINBUK (Pusat Inkubasi Bisnis Usaha Kecil) or

Center for Micro Enterprises Incubation, registered 175,102 microfinance institutions all over Indonesia which brought total assets of 77,514,341.36 million Rupiahs.¹² This reflected the strong demand for microfinance sectors, compared to the year 1985, when rural microfinance sector registered only 6,629 microfinance institutions, with total assets of 31,957 million Rupiahs.

Thus, the key statistic of Indonesian micro finance's development discussed above proves that despite the bearish condition under the Dutch colonization, the sectors of microfinance continuously grew slowly. But after the independence of Indonesia, these sectors saw a tremendous growth and became large enough to be empowered. Besides that, with this development and tremendous growth, Indonesia can be regarded as the first country among Association of South-East Asian Nations (ASEAN) countries to provide types of

microfinance.¹³ This reflected the strong demand of Indonesian people to uphold the economic and financial system as one of the important structures of the country's development.

Moreover, Indonesian government itself continuously encouraged the development of microfinance or cooperative sectors until today. A number of economic policies concerning the development of microfinance in the field of institutions, businesses, credit guarantees or entrepreneurship policy in the framework of microfinance research and development have issued. For example, the government of Indonesia has successfully and jointly issued decrees of three ministries, namely: (YINBUK). PINBUK

¹²According to Seibel (2003), the most important promoter of Islamic cooperatives in Indonesia is the Centre for Micro Enterprise Incubation or *Pusat Inkubasi Bisnis Usaha Kecil (PINBUK)*, established in 1995 by the Indonesian Intellectual Muslims Association or *Ikatan Cendekiawan Muslim Indonesia (ICMI)*, Indonesian Ulama Council or *Majelis Ulama Indonesia (MUI)* and Bank Mu'amalat Indonesia (BMI) under a foundation called as Foundation for Small Business Incubation or *Yayasan Inkubasi Bisnis Usaha Kecil*

¹³ In Malaysia, the establishment of Amanah Ikhtiar Malaysia (AIM) as a microfinance institution in 1987 was earlier than BMT institution in Indonesia, where it was established only in 1990. However, this institution still cannot be regarded as the first Islamic microfinance institution because besides its products and services based on *Shari'ah* transactions, this institution operated as well by conventional system. AIM institution charges the borrowers an interest (*riba*), although a lower interest rate of up 10 percent per annum. See, Raziah Md. Tahir, *Mecanism of Operational of Credit Financing in Amanah Ikhtiar Malaysia (AIM): An Analysis form Islamic Perspective*, (Ph.D Thesis, USM, 2014), p.9. See also, <<http://www.aimwilayahsababharat.blogspot.com/p/produk.html>>(accessed, May, 5th 2015).

facilitates the establishment and licensing of new BMT institution before registering it with the Ministry of Cooperatives and Small Medium Enterprises (SMEs). PINBUK provides basic, intermediate and advanced training, plus training of trainers. It offers a wide range of training modules with support from the government, colleges or universities and Non Governmental Organizations (NGOs). See, Hans Dieter Seibel, *History Matters in Microfinance*, 2003, 15. Ministry of Finance No.: 351.1/KMK.010/2009, Ministry of Home Affairs No.: 900-639A/2009, and Ministry of Cooperatives and SMES No.: 01/SKB/M.KUKM/IX/2009, along with Indonesian Bank Governor No.: 11/43A/KEP.GBI/2009.¹⁴

Subsequently, the other most important development of microfinance sectors in Indonesia that attracts the highest attention was the establishment of the Islamic microfinance in 1990. The development of Islamic microfinance has been paralleled by Islamic banking, known as *Bank Mu'amalat Indonesia (BMI)*. In the same time, Ridho Gusti Cooperative in Bandung (East Java) has the distinction of being the first Islamic microfinance

institution in Indonesia, which has launched an Islamic micro products and services based on Islamic law of financial transactions (*fiqh al-mu'amalat al-maliyyah*).¹⁵ After 1995, when PINBUK has started in promoting Islamic microfinance institutions all over Indonesia under the new name, i.e. *Bayt al-Mal wa al-Tamwil (BMT)* institution, their number evolved in four stages of growth and development, namely: (1) an initial period of moderate growth up to 1995; (2) the promotion of rapid growth by PINBUK starting from 1995, with big jumps in numbers during the economic and politic crisis situation in 1997 and 1998; (3) a slowing-down of growth

¹⁴ See, Appendix for a jointly decrees of three Ministers and the Governor of central Bank of Indonesia (BI) used in the study.

¹⁵ BMT institution in carrying out its business operations usually is similar to the banking operation system governing and controlling the flow of funds from the surplus spending units to the deficit spending units in the form of Islamic products and services that required by their members and surrounding communities. To some extent, this is consistent with Rosly assertion that the household, business and government sectors should make up both the surplus spending and deficit spending unit. For example, households with excess income lend their money to households with negative savings. See, Ahmad Djazuli, *Economic institutions for Muslim people: An Introduction*, (Jakarta: Raja Grafindo, 2002), 24.; See also, Saiful Azhar Rosly, *Critical issues on Islamic and financial markets: Islamic economics, banking & financial, investments, takaful and financial planning*, (Kuala Lumpur: Dinamas Sdn. Bhd., 2005), 9.

during 2000 and followed by stagnation; (4) then after year 2000, they continued with big jumps and development.¹⁶ See table 1.3 below regarding the evolution of Islamic microfinance such as BMT institutions in Indonesia.

Table 1.3:
The Evolution of Islamic
Microfinance of BMT Institutions
in Indonesia

Phase of Growth & Development	Periods of BMT Institution	Number of BMT Institutions
<i>Initial growth</i>	1990-1995	300
<i>Rapid growth</i>	1996	700
<i>(beginning promoted by PINBUK)</i>	1997	1,501
	1998 (June)	2,470
<i>Slowing down of growth</i>	2000	2,938
<i>Slowing down and stagnation</i>	2001	3,037
	2003	2,856
<i>Rapid growth (promoted by PINBUK, Ministry Cooperative & SMEs)</i>	2010	3,900

Source: Seibel (2004), *Islamic Microfinance in Indonesia*, 93.

Kholis (2004) ¹⁷has

¹⁶ Hans Dieter Seibel, *Islamic Microfinance in Indonesia*, 2004, 35.

¹⁷ Nur Kholis, "Evaluation to The Practice of *Murabahah* in The

clarified that BMT is an Islamic microfinance institution, established by Muslim society in Indonesia. It takes initiatives to help micro entrepreneurs as a strategy for eradicating rural poverty especially in villages or traditional markets. It is operationally based on *Sharī'ah* principles and Islamic values. Nowadays, BMT institutions are emerged among the Indonesian society because of some aspects, such as: (1) there are more than 43,22 millions of micro entrepreneurs in Indonesia; (2) there are just a few Islamic banks having good attention and willingness to provide credit or financing schemes for micro entrepreneurs.

According to Seibel (2004),¹⁸ the establishment of PINBUK was encouraged by the harsh reality of the economic positions of Muslims due to the policy of the new era called "Orde Baru (ORBA)" during 32 years of President Suharto regime that was in favour of the conglomerates. PINBUK aims to realize the Islamic microfinance sector as the most fundamental issue for small enterprises to be empowered. Therefore, PINBUK set up as much as possible of BMT institutions in all parts of the country with the expectation to

Operations of *BMT Dana Sharī'ah*, Yogyakarta, *Jurnal La_Riba*, ISSN 1978-6751, vol. 1, no. 1, (July 2007): 3.

¹⁸ Hans Dieter Seibel (2004), 36

help the entire local communities, especially the Muslim entrepreneurs. The presence of BMT institutions in many villages and towns all over Indonesia has brought better local economic development in the country, such as agriculture, animal husbandry, trade, crafts people and other informal economic growth.

As of the end of 2010, around 4000 BMT institutions were spread in 36 provinces from Sabang (Aceh) to Merauke (Irian Barat) and registered at PINBUK. The achievement of BMT institutions, however, is still considered small in numbers, compared to the capital needs of businesses, markets and other sectors surrounding the 39.5 million of small enterprises across the country. If each BMT institution could finance about 200 small entrepreneurs on average, the number of BMT institutions need to be established for 39.5 million small enterprises is 197, 500 BMT institutions.¹⁹

Thus, the development of BMT institutions can be deemed as an alternative economic system in the country, with the expectation of serious attention from the government and all societies, especially Muslims, in order to encourage faster growth of BMT institutions in the midst of society.

¹⁹ PINBUK Center, (2010)

<<http://www.pkesinteraktif.com>>(accessed , October 6th, 2010).

Conclusion

The Islamic microfinance institution model such as *Bayt al-Mal wa al-Tamwil (BMT)*, became the pioneer for the Islamic microfinance system in Indonesia. BMT institution was established by Indonesian Muslims to overcome *riba* based economy in the country, to decrease the power of conventional banking and financial system, to abolish the moneylenders' system and to eradicate rural poverty and especially to help Muslim micro entrepreneurs in Indonesia. BMT institution model has become the most simplified form of Islamic financial institution in Indonesia.

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