

HISTORICAL DEVELOPMENT OF ISLAMIC MICROFINANCE IN INDONESIA

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Abstract

Microfinance sector has become one of the most popular strategies for poverty alleviation and developing microenterprises in both developing and industrialized countries, including the Muslim countries. In Indonesia, microfinance sector was considered as the backbone of the country's economy in accommodating the role of the poor people in the structure of country's economy, encouraging wider employment opportunities for them in accessing funds and providing the most affordable and simplest funds to develop their businesses and enhance their quality of life. Based on recent data obtained from the central Bank of Indonesia (BI), the performance of the cooperatives or microfinance sector in Indonesia during 2010 has reached approximately 51,3 million Rupiah (96.77%) of total micro enterprises compared to 3,23% for medium enterprises. Besides that, it has contributed 2,609 trillion Rupiah (55.6%) of total products and services based on Growth Regional Domestic Products (GRDP) and 183,8 trillion Rupiah (20.00%) of total foreign exchange. This achievement indicates the growing importance accorded to the microfinance sector as a tool of poverty alleviation and strategy to develop microenterprises in Indonesia. In this chapter we introduce the BMT institution model from Indonesia and its products and services as important vehicles in the grass root economics and financial system which might contribute to the national economy in attempting the poverty alleviation and abolishing the riba system and prohibited elements.

Keyword: *Microfinance, Islamic microfinance, poverty alleviation, riba system, shari'ah, Bayt al-Mal wa at-Tamwil (BMT), Small and Medium Enterprises (SME).*

Introduction

As a sacred trust, property is given to humankind as its trustee to utilize it in the most efficient manner to produce maximum output and to

fulfill Allah's plan of establishing prosperity in this world. Therefore, Islamic commercial law was revealed to ensure that the property will not be placed in jeopardy through unfair dealings.¹ Hence, the

¹Ibn 'Abidin (n.d.) divides and clarifies the meaning of Islamic commercial

law in to five transactions in Islamic law of financial transactions (*fiqh al-mu'amalat al-*

Islamic commercial law totally disallows usury (*al-riba*),² gambling (*al-maysir*),³ hoarding (*al-ihthikar*),⁴ uncertainty (*al-gharar*)⁵ and other forms of exploitation that will make financial transactions invalid and prohibited.⁶

Furthermore, Islamic commercial law was founded on the religious philosophy, i.e.

maliyyah), namely; commutative contracts (*al-mu'awadat al-maliyyah*), family institution (*al-munakahat*), quarrels (*al-mukhasamat*), trusteeship (*al-amanat*) and inheritance (*al-tarikat*). See, Muhammad Amin Ibn 'Umar Ibn 'Aziz ibn 'Abidin al-Damshiqi, (n.d), *Hashiyat Radd al-Muhtar 'Ala al-Durr al-Mukhtar Sharh Tanwir al-Absar (Hashiyat Ibn 'Abidin)*, (Beirut: Dar al-Fikr, 2000), vol. 1. 79. Shubayr (1996) defines Islamic commercial law as the legal provisions governing financial transactions between the people or institutions which include the financial trade-off (*al-mu'awadat*) instruments such as sale (*al-bay'*), leasing (*al-ijarah*) or donations (*al-tabarru'at*) such as gift (*al-hibah*), will (*al-wasiyyah*), endowment (*al-waqf*) or setting off the projection (*al-isqhatat*) such as discharge of debt (*al-ibra'*) or equity partnership (*al-musharakat*) or documentation of collateral (*al-tauwthiqhat*) such as pawn broking (*al-rahn*), insurance (*al-ta'minat*), transfer (*al-hiwalat*). See, Muhammad 'Uthman Shubayr, *al-Mu'amalat al-Maliyyah al-Mu'asirah fi al-Fiqh al-Islami*, (Jordan: Dar al-Nafa'is, 1996), 10. AAOIFI defines Islamic commercial law as a branch of Islamic law (*Shari'ah al-Islamiyyah*), focusing on what types of contract or transaction are valid and what types are invalid. See, Simon Archer and Rifa'at Ahmad Karim, *Islamic Finance: Innovation and Growth*, (London: Euromoney Books and AAOIFI, 2002), 3.

achievement of *al-falah* (success) in the worldly life and more importantly, in the Hereafter. Islamic commercial law is constructed upon the principles of cooperation (*al-ta'awun*),⁷ justice (*al-'adl*),⁸ benevolence (*al-ihsan*),⁹ and trust (*al-amanah*).¹⁰ The Qur'an, al-Sunnah and the consensus of Muslim jurists (*al-ijma'*) state that

²The Qur'an states clearly that usury (*al-riba*) is forbidden in Islam (al-Baqarah: 275-281; Ali 'Imran: 130-132); al-Nisa': 160 and al-Nisa': 30-39).

³The Qur'an states clearly that gambling (*al-maysir*) is forbidden in Islam (al-Baqarah: 219; al-Ma'idah: 90-91).

⁴The Qur'an states clearly that hoarding or amassing of wealth (*al-ihthikar*) is also forbidden in Islam (al-Ma'arij: 18; al-Fajr: 20; al-'Adiyat: 1-11; al-Humazah: 1-4).

⁵The Qur'an states clearly that uncertainty (*al-gharar*) is forbidden in Islam (al-Baqarah: 188; al-Nisa': 29).

⁶According to Kharofa (2009), about thirty-three contracts are prohibited in Islamic commercial law. See, Ala' Eddin Kharofa, *Transaction in Islamic Law*, (Kuala Lumpur: Zafar Publication Sdn. Bhd., 2009), 73-89.

⁷The Qur'an states clearly that cooperation (*musharakah*): (al-Nisa': 29; al-Ma'idah: 2).

⁸The Qur'an states clearly that justice (*al-'adl*) is commanded in Islam (al-Nisa': 135; al-Ma'idah: 8; al-An'am: 152.; al-A'raf: 29; al-Nahl: 90; al-Mumtahanah: 8).

⁹ Benevolence (*al-ihsan*) is commanded in Islam (al-Baqarah: 195; Ali 'Imran: 134, 148; al-Nisa': 136; al-A'raf: 56; al-Qasas: 77; al-Zumar: 10).

¹⁰The Qur'an states clearly that honesty or trust (*al-amanah*) is commanded in Islam (Ali 'Imran : 76; al-Ra'ad: 20; al-Mu'minun: 8; al-Ma'arij: 32).

the prohibitions and principles mentioned above are not solely restricted to an individual contract, but they encompass the entire traditional and modern economic and financial systems, such as banking, insurance, capital market, pawn-broking and microfinance.¹¹

Historical Development of Microfinance and BMT's Model

In the context of modern economic and financial systems, microfinance has become an interesting topic of discussion among economists because this topic is not only a form of awareness on the needs of the poor, but indeed contains a powerful economic potential that has not been fully explored. Microfinance is a system which takes into account the limitations of the poor, who have difficulty or limited access to financial services or banking institutions.¹²

Microfinance institution therefore provides the entrepreneurial poor with financial

services that are tailored to their needs and conditions. Good microfinance programmes are characterized by small, usually short-term loans; streamlined, simplified borrower and investment appraisal; quick disbursement of repeated loans after timely repayment; and convenient location and timing of services.¹³

In the last few years, microfinance has become one of the most popular strategies for developing microenterprise in developing countries. Therefore, the establishment of microfinance institutions that can serve the needs of micro entrepreneurs in obtaining fund is necessary. This fund is required to give them an opportunity to develop their business and enhance their quality of life. Professor Mohammed Yunus in Bangladesh has become a leading figure in microfinance today. He successfully established the "Grameen Bank" or "Village Bank" which he has been striving to establish since 1976.¹⁴

¹¹Muhammad 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*, (Australia: Unpublished Ph. D Dissertation, University of Wollongong, 1996), 149.

¹²Mohammed Obaidullah, "Frame Work and Strategies for the Development of Islamic Microfinance Services." *A paper presented at a Seminar on Islamic Microfinance Development: Challenges and Initiative*, Senegal (2007), 4.

¹³Ibid.

¹⁴See, M. A. Mannan, "Alternative Credit Models in Bangladesh: A Comparative Analysis Between Grameen Bank and Social Investment Ltd: Myths and Realities." *A paper presented at the First International Islamic Conference on Inclusive Islamic Financial Sector Development*, (Brunei Darussalam, 2007): 23. See also, Rodney Wilson, "Making Development Assistance Sustainable through Islamic Microfinance". *A paper presented at IIUM International Conference on Islamic Banking and Finance*, (Kuala Lumpur: IIUM, 2007): 4.

Furthermore, this bank was founded on the principles of trust and solidarity to help the rural poor and lower income groups in running micro-businesses by offering them small loans, especially to poor women. This success has attracted the attention of the world to follow in his steps and he earned a Nobel Peace Prize on 13 October 2006 as a result of his commitment and struggle. Moreover, the United Nations (UN) determined that the year 2005 should be the “International Year of Microfinance”.¹⁵

July 12th is commemorated as the cooperative day in Indonesia. According to Seibel and Agung (2007),¹⁶ Indonesia has a highly differentiated micro and rural finance sector among developing countries which has evolved and initiated for 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).

According to Masngudi (2003),¹⁷ *Schulze-Delitzsch* (1896) was further developed by *De Wolf Van Westerode*, the Assistant of Dutch Resident in Banyumas Region in Central Java, 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-^cInan*, 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

¹⁵Ibid.

¹⁶Hans Dieter Seibel, “History Matters in Microfinance”, *International Journal of Microfinance and Business Development Germany*, vol. 14, no. 2 (June 2003): 8.

¹⁷Masngudi, *History of Cooperatives in Indonesia*, (Jakarta: Ministry of Cooperatives and SMEs of Indonesia, 1990), 9-10.

political strategy to take care of people's concern.¹⁸

However, after the Indonesian independence in 1945, microfinance or cooperative movement based on the conventional system has been going through up and down situations. On one hand, the cooperative sector was considered as a model for empowering the people's economy, but on the other hand, it was still unable to improve their economy because this system was based on interest (*riba*) and prohibited elements. As a result, most of the people in the past did not trust in cooperative or micro sector anymore.¹⁹

Due to this failure, 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.²⁰

BMT institution model has become the most simplified form of Islamic financial institution in Indonesia. Most of them are small and run in the form of cooperative type of business and regulated by the Act of Ministry of Cooperative and Small Medium Enterprises No. 01/SKB/M.KUKM/IX/2009, the Act of Ministry of Finance No. 351.1/KMK.010/2009, the Act of Central Bank Governor No. 11/43A/KEP.GBI/2009 as well as the Act of Ministry of Home Affairs No. 900-639A Year 2009.²¹

Currently, there are approximately 4000 BMT institutions all over Indonesia with assets worth about 18 trillion rupiah that serve more than 2 million depositors and lend more than 1.5 million micro entrepreneurs. Nevertheless, the country still needs around 80,000 BMT institutions to serve 52 million micro entrepreneurs in Indonesia. The performance of BMT institution is based on the Islamic economic fundamentals and economic values. Therefore, their products and services must be *Sharī'ah* compliant and approved by the *Sharī'ah* Supervisory Board (SSB) before they are promoted and commercialized to the public.²²

¹⁸Ibid.

¹⁹Ibid.

²⁰Ibid.

²¹See, Appendix for A Jointly Decrees of Three Ministers Act in collaboration with the Central Bank of Indonesia (BI) used in this study.

²²Center for Micro Enterprises Incubation or *Pusat Inkubasi Bisnis Usaha Kecil (PINBUK)* and Ministry of Cooperatives and SMEs of Indonesia (2010). <<http://republika.co.id>>. (accessed 30 November, 2011).

Conclusion

Microfinance sector in Indonesia is considered as the backbone of the country's economy in accommodating the role of the poor people in the structure of the country's economy, encouraging wider employment opportunities for them in accessing funds and providing the most affordable and simplest funds to develop their businesses and enhance their quality of life. Thus, BMT institutions of Indonesia are considered as the most successful kind of non-formal financial organizations, which play their role as financial intermediaries. Moreover, BMT institutions have succeeded in integrating both business and social activities in the immediate society based on Islamic law and values. Although, some BMT enterprises are small but most of them have large networks and serve over thirty millions of poor Indonesian Muslims.

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