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Developing an Islamic Microfinance Model Using Koperasi Concept for Islamic Bank in Indonesia for Poverty Alleviation

By

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Abstract

Purpose – The main purpose of this paper to review the conventional microfinance concept which based on *riba* and replace it with Islamic microfinance through Koperasi incorporated with Islamic bank in Indonesia.

Design/methodology/approach – The paper is based on comprehensive review of conventional microfinance with the objective to propose a new Islamic microfinance model that based on Shariah.

Findings – This paper reviewed the concept of microfinance base on the traditional financial intermediary. Moreover, other than *building human capacity* through social intermediation and designing group-based lending programmes are proven to be among the effective tools to reduce transaction costs and lower exposure to numerous financial risks in relation to providing credit to the rural poor in many countries especially in India (Gramen Bank). This paper also suggests to trained the group regarding to management and business and the concept of 'Ashabiyyah and Ta'awun (cooperative among the members) also given to strengthen the model. Therefore, this paper suggests to Islamic bank to use Koperasi as a partner as one of the possible alternatives to finance the potential poor.

Research limitations/implications – Islamic bank may benefit from different sources of fund, not only from the bank, but also from Infaq, Sadaqah, and Zakat to finance the potential poor. The use of Koperasi in this model is to revive the BRI concept of Koperasi who had ever advanced in the past by adding Shariah values in the model.

Originality/value – The analysis is valuable in drawing the attention of Islamic banking practitioners to the fact that this model can be implemented without compromising the institutional viability, competitiveness and sustainability. This is evident from Koperasi intermediation model where they can always monitoring the group and each group members monitoring other members.

Keywords: Islamic Bank, Microfinance, *Koperasi*, Islam, unemployment and Poverty

Paper type - Research Paper

1. Introduction

Indonesia is one of the biggest countries' populations in the world. At the same time, the issues of poverty and unemployment are the greatest challenges faced by Indonesian government, a large number of studies on poverty indicate that exclusion of the poor from the financial system and service is a major factor contributing to their inability to participate in economic development. Islamic Bank as one of Islamic financial institution that basically based on shariah rules and principle encouraged becoming a leader on channeling fund to the poor people, low income and economic level of life. The role of Islamic bank here as a Microfinance institution that channeling fund to the poor via *koperasi* through social intermediation and group-based lending program from a plenty a sources, not only from bank itself as internal sources but can also can be taken from zakat, cash waqf, and sadaqah as an external sources.

In order to have a good economy and social life Islam encourages people to do business and entrepreneurship, because one hadith mentioned that more than ninety percent of al-rizqu given to entrepreneur. The issue is that the poor people have no capital (money) to start business and no link to financial services. Therefore, we face the issue miss information between poor and bank especially Islamic bank as proposed to take a role as an Islamic microfinance institution to channel the fund to the poor.

Microfinance means "programme that extend small loans to very poor people for self employment projects that generate income in allowing them to take care of themselves and their families" (Rahman, 2007). Microfinance is one of a powerful tool and instrument that can alleviate poverty. It means provision of financial services to poor and low-income people whose low economic standing excludes them from formal financial system to access such as, credit, venture capital, savings, insurance, remittance is provided on a micro-scale enabling participation of those with severely limited financial means. The provision of financial services to the poor helps to increase household income and economic security build assets and reduce vulnerability; creates demand for other goods and services (especially nutrition, education, and health care); and stimulates local economies (Obaidullah and khan, 2008).

Hence the poor having difficulty to access to the fund due to non-qualify person, we have to have a good scheme to propose to Islamic bank that might be used to overcome the issue. Therefore, the objective of this paper is to propose to Islamic bank in Indonesia to take a role in microfinance for funding the poor and small (micro) entrepreneurs without charging interest (*riba*) but apply profit and loss sharing scheme in every contracts. In the first part the paper will discuss about definition of microfinance and prohibition of Islam in micro credit, second part will discuss the issue of poverty and unemployment in Indonesia and why microfinance needed in this case, third will discuss how microfinance will take over by Islamic bank by introducing Koperasi scheme, the sources of fund and what are the barriers in this structure. The paper also discuss the issue of '*ashabiyyah* to overcome the issue of untrustworthy in this group lending. Finally the paper concludes by encouraging the Islamic bank in Indonesia to use this scheme as microfinance product in current system.

2. Definition, concept and role of microfinance in economics system

The microfinance initiatives are become more popular today in many Islamic countries although previously it was dominated by conventional system. Many articles and paper are written regarding the idea or model on how to Islamize the microfinance. Microfinance refers to making small loans available to poor people (especially those traditionally excluded from financial services) through programmes designed specifically to meet their particular needs and circumstances (Khan, 2008). Microfinance also known as programme that extends small loans to very poor people for self-employment projects that generate income in allowing them to take care of themselves and their families (Rahman, 2007). One of the clearest frameworks of microfinance has been put forward by Prof. Dr. H. D. Seibel who defines microfinance as follows: "A sector of formal and non-formal financial institutions providing micro saving, microcredit 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. In a wider sense, they may also comprise national or regional banks with microfinance services for small savers and borrowers"[1].

Among the features of microfinance is the disbursement of small size loan to the recipients that are normally micro entrepreneurs and the poor[2]. It means that the loans are giving away to them with the purpose of generating income from new project or business expansion. Normally, the terms and conditions of the loan are easy to understand and very flexible due to their circumstances. It is provided for short term financing and repayments can be made on a weekly or longer basis. The procedures and processes of loan disbursements are normally fast and easy. Additional capital can also be given after the full settlement of the previous loan[3]. Microfinance institutions provide to the entrepreneurial poor financial services that are tailored to their needs and conditions. Good microfinance programs are characterized by small, usually short-term loans; streamlined, simplified borrower and investment appraisal; quick disbursement of repeat loans after timely repayment; and convenient location and timing of services (Obaidullah and Khan, 2008).

The primary mission of microfinance is, therefore to help poor people in assisting themselves to become economically independent (Rahman, 2007). There are several writers that mentioned in their paper regarding the foremost objective of microfinance institutions which is to alleviate poverty. It is widely believed that microfinance programmes will raise incomes and broaden financial markets by providing credit, among other services, to small scale entrepreneurs (Shimelles and Zahidul, 2009). 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[4].

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[1] See www.assaif.org/.../**Islamic**%20**Microfinance**%20framework%20and%20strategies.pdf on 12 October 2010.

[2] ibid

[3] ibid

[4] ibid

3. Reviews on Present Scheme

Most of the microfinance institutions have non-Islamic characteristics mainly because their interest-based of financing (Habib, 2004). Conventional microfinance institutions (MFIs) have often been criticized for charging the poor exorbitant interest rates and fees. This is largely due to the higher transaction costs incurred, including the provision of services such as monitoring, advice and health insurance (Wilson, 2007). Yet, there are not many Islamic microfinance institutions and they exist only in a few countries[1]. 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. There are inadequacy number of Islamic Microfinance and only a number of *shari'ah* compliant microfinance schemes, notably those operated by Hodeibah microfinance program in Yemen, the UNDP *Murabahah* based microfinance initiatives at Jabal al-Hoss in Syria, *Qardhul Hasan* based microfinance scheme offered by Yayasan Tekun in Malaysia, various schemes offered by Bank Rakyat Indonesia, and Bank Islam Bangladesh (Rahman, 2007).

Here is some of the overview of Islamic microfinance in several developed countries especially in South Asia and Southeast Asia from Islamic Microfinance Report (2009). In Pakistan, apart from the banks that provide microfinance services, there are some others Islamic microfinance institutions name as *Akhuwat* and Islamic Relief which based on *qard hasan* and *murabahah* financing. Pakistan has developed a unique mosque-centred structure. There is no funding from international donors or financial institutions. All activities revolve around the mosques and involve close interaction with the community. Meanwhile, in Bangladesh, as the first countries to adopt microfinance, they used *murabahah* and *bai' muajjal* based on the lending principles as their financing instruments. The Grameen system dominates the market in Bangladesh, where it has been widely imitated by a range of large and small MFOs. The system was pioneered by Professor Yunus in 1976, and has grown very rapidly since. In Indonesia, they maintain a dual conventional/Islamic microbanking system, which includes both conventional rural banks (Bank Perkreditan Rakyat or BPRs) and *Shari'a*-compliant rural banks (Bank Perkreditan Rakyat Syariah or BPRSs). Each BPRS has a *Shari'a* board to monitor the conformity of products to Islamic principles. In contrast with many single-product Islamic microfinance programmes in other countries, the financing portfolios of Indonesian IMFIs are reasonably balanced with an array of products based on *murabaha*, *musharaka*, *mudaraba*, *ijara* and *qard al-hasan*. However, Malaysia has established several organisations under the aegis of

[1]ibid

government agencies to provide microfinance to small- and medium-sized enterprises using a wide range of Islamic financial products. In addition to financial institutions, efforts have also been made to diversify sources of loans for micro-enterprises and the poor, which includes Amanah Ikhtiar Malaysia and Islamic pawn broking (*Ar Rahnu*).

4. Issue of Poverty and Unemployment in Indonesia

The issue of poverty and unemployment has been always become an enemy to the society worldwide. These two issues always become logo for presidents' candidates and head of the state who wants become a leader have to take care these two in order to get sympathy from majority of people, because if these two issues settled, all the people become happy and indicate that his/her leadership success.

According to Mihajat (2010), In Indonesia, this two elements from my humble understanding, observation, and analysis increase year by year, even though the government claim it decrease depend on how much the income per month they measure to decide whether this family poor or not. According to BPS (Badan Pusat Statistik), the data of poverty in Indonesia decrease from 1998 by 24.23% to 2005 by 15.97%, and increase a bit in 2006 by 17.75% and decrease in 2007 16.58 and 2008 by 15.42%. (Look at table 1.1)

Table 1.1

A Number and Percentage of Poverty in Indonesia By Region, 1996-2008

Year	**A Number of Poverty (million)**			**Percentage of Poverty (million)**		
	Urban	**Rural area**	**Urban and Rural Area**	**Urban**	**Rural area**	**Urban and Rural Area**
(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**
1996	9,42	24,59	34,01	13,39	19,78	17,47
1998	17,60	31,90	49,50	21,92	25,72	24,23
1999	15,64	32,33	47,97	19,41	26,03	23,43
2000	12,30	26,40	38,70	14,60	22,38	19,14
2001	8,60	29,30	37,90	9,76	24,84	18,41
2002	13,30	25,10	38,40	14,46	21,10	18,20
2003	12,20	25,10	37,30	13,57	20,23	17,42
2004	11,40	24,80	36,10	12,13	20,11	16,66
2005	12,40	22,70	35,10	11,68	19,98	15,97
2006	14,49	24,81	39,30	13,47	21,81	17,75
2007	13,56	23,61	37,17	12,52	20,37	16,58
2008	12,77	22,19	34,96	11,65	18,93	15,42

Source: Badan Pusat Statistik (BPS), No. 43/07/Th. XII, 1 Juli 2009.

The development of a number of poverty in Indonesia on March 2008 is 34.96 million people (15.42%) compare to poverty on March 2009 decrease by 2.43 million or 32.53 (14.15%). The number of poor people in rural area decrease significantly compare to urban area, from March 2008-March 2009 poor people in rural area reduce by 1.57 million people but in urban area only reduce by 0.86 million (Look at table 1.2).

Table 1.2

Poverty Line, Quantity and Percentage of Poor people According by Region March 2008-March 2009					
Region/Year	**Poverty Line (Rp/Capita/Month)**			**Quantity of Poor People (Million)**	**Percentage of Poor People**
	Food	**Non-Food**	**Total**		
(1)	(2)	(3)	(4)	(5)	(6)
Urban					
March 2008	143 897	60 999	204 896	12,77	11,65
March 2009	155 909	66 214	222 123	11,91	10,72
Rural					
March 2008	127 207	34 624	161 831	22,19	18,93
March 2009	139 331	40 503	179 835	20,62	17,35
Urban+Rural					
March 2008	135 270	47 366	182 636	34,96	15,42
March 2009	147 339	52 923	200 262	32,53	14,15

Source: Badan Pusat Statistik (BPS), No. 43/07/Th. XII, July first 2009.

The Indonesian battles are to reduce unemployment and poverty, many programmes and actions has been done by government to reduce these two, such as giving BLT (*bantuan langsung tunai*) to the poor people even though this action from my opinion its not the right way, we have another way that we can do such as combination of *Sukuk*, *zakat* and *waqf* that I want to proposed in this paper on doing project and business activity that can generate income for local government and increase GDP for national income.

Base on CIA World Factbook data, the unemployment rate in Indonesia from 2006 is 12.50% and decrease in three years in 2010 is only 7.70%.[1] (Look at table 1.3 and chart 1.1)

[1] See on www.indexmundi.com/indonesia/unempyment_rate.html, access on 10/04/2010.

Table 1.3

Year	Unemployment Rate	Rank	Percent Change	Date of Information
2003	10.60	92		2002 est.
2004	8.70	111	- 17.92	2003 est.
2005	9.20	82	5.75	2004 est.
2006	11.80	121	28.26	2005 est.
2007	12.50	133	5.93	2006 est.
2008	9.10	115	-27.20	2007 est.
2009	8.40	115	-7.69	2008 est.
2010	7.70	80	-8.33	2009 est.

At the other hand, there is good intention from our president (SBY) who has planning namely the five-year development plan *Pelita* in reducing poverty and unemployment, many economists' expert doubt this programme to be achieved. At the same time national economic development growth is only 7% per year, lower than the threshold of poverty to 8%, reduce unemployment rate to 5%, so it is not easy to achieve the objective of this programme. To realize this programme, a summit On October 29 and 30 has been held in Jakarta organized by the Chamber of Commerce and Industry, attended by over 1000 people, a summit with the theme "*Making a Prosperous, Judicious and Democratic Indonesia*". It brought together financial experts, businessmen, government officials and officers leading the country. During the opening ceremony, SBY emphasized that "any hurdles to boost economic performance should be seriously tackled." This statement to show how serious he is in alleviating poverty and reducing unemployment (Asianews.com, October 2009).[1]

Therefore, the main objective in this paper to help and propose a model of microfinance that based on shariah to Islamic bank in catering these two issues (unemployment and poverty) that basically bring in to a social problem in the society.

5. Microfinance and Islamic Banking

Islam is a comprehensive religion covers all sectors of human life, individual and social, material and moral, economic and politic, legal and cultural, national and international and soon. Since the objective of microfinance is to channel the fund to the poor whose need capital to do business and Islam encourages people to do business to increase economic growth and help the poor to achieve the fairness of equality of income so Islam and microfinance has the same objective.

[1] www.asianews.com, saturday, october 31, 2009, access on 9/04/2010.

However, the current practices of microfinance including grameen bank founded by Muhammad Yunus is basically base on riba. Therefore, this paper proposing microfinance has to be base on profit and loss sharing and real economic activity. Since Indonesia is one of the largest Muslim' country in the world and poverty and unemployment still high, the emergence of microfinance will become tool to alleviate poverty and reduce unemployment. According to Rahman (2007) the main aim of Islamic banking and finance is to provide the Muslim society with an Islamic alternative to conventional banking system that based on *riba*. Riba can be classified into at least two main types, namely credit riba (riba al-nasi'ah) and surplus riba (riba al-fadhl) (al-Zuhayli, 2006). Credit riba is any delay in settlement of a due debt, regardless whether the debt of goods sold or loan. Muslim jurists define riba al-nasia'ah in loans as bringing to the lender a fixed increment after an interval of time, or extension of time over the fixed period and increase of credit over the principal. On the other hand, surplus riba (riba al-fadhl) is the sale of similar items with disparity in amount in the six canonically forbidden categories of goods: gold, silver, wheat, barley, salt, and dry dates. This riba is appear by way of excess over and above the quantity of the commodity advanced by the lender to the borrower. Riba can also exist if there is either inequality or delay in delivery of goods offered. In Islam, we can delay either goods (salam) or price (BBA) we cannot delay on price and goods at the same time.

As explained by Qureshi (1991), Imam Fakhruddin Razi in his book *al-Tafsir al-Kabir* emphasizes that there are basically 3 reasons for the unlawfulness of *riba'*. The first reason is where the creditor's can ensure its income from the interest paid by the debtor that will lead to the exploitation and living in reduced circumstances which is a massive inequity. Charging excess or surplus in exchanging one commodity against the other will lead to the exploitation of the borrowers. The borrowers would have to pay back the interest on top of the principal. This will make the lenders better off at the expense of the borrowers. In addition, the strong condemnation of interest-based transactions is intended to uphold equity and the protection of the poor (i.e. the borrower). In other words, interest or *riba'* supports the possibility for wealth to accumulate in the hands of a few, and thereby it shows that man's concern for his fellow men is decreased.

Secondly, since interest or *riba'* is predetermined and the creditor is certain to receive the interest imposed, it may prevent the creditor from being involved in any occupation because it is certainly easy to receive income from the interest on a loan [Qureshi 1991]. In this situation, the creditor has not made any effort or undergone any hardship in acquiring income and this will hinder the progression of worldly affairs. Finally the unlawfulness of *riba'* is due to an end of mutual sympathy, human goodliness and obligations because the practice of *riba'* may lead to borrowing and squandering [Qureshi 1991].

As an alternative to *riba'*, the profit and loss sharing arrangements are held as an ideal mode of financing in Islamic finance. It is expected that this profit and loss sharing will be able to significantly remove the inequitable distribution of income and wealth and is likely to control inflation to some extent [Siddiqui 2001]. Furthermore, the profit and loss sharing may lead to a more efficient and optimal allocation of resources as compared to the interest-based system. Since the depositors are likely to get higher returns leading to richness, it is hoped that progress towards self-reliance will be made through an improved rate of savings. Thus will ensure justice between the parties involved, as the return to the bank on finance is dependent on the operational results of the entrepreneur [Siddiqui 2001].

Consequently, the theory of Islamic finance gives rise to the development of Islamic banking where the functions of a bank do not vary between conventional and Islamic banks. However, the operations, philosophy, and objectives differ significantly between the conventional and Islamic Banks [Ziauddin 1991]. Conventional bank operates its business in the capitalist system where the root of the system is based on interest and *riba'*. On the other hand, the Islamic bank provides the solution to the Muslims in terms of principles, instruments and issues in dealing with banking business activities where the operations of the activities are based on the principles of the *Shari'ah* that avoid the issue of riba, gharar, and gambling by encouraging profit and loss sharing instrument (Ahmad and Ahmad, 2009).

6. The Role of Islamic Banking

The development of Islamic banking in Indonesia increase significantly over the year since the demand of Islamic banking by the customers is huge and enthusiastic. However, there is one missing component that does not take into consideration by Islamic bank which is microfinance for the poor.

There are reasons why bank reluctant to give financing to the poor, one of the important elements is trust. The basis of trust depends on two critical elements: first is the applicant's reputation as a person of honor; and second is the availability of enough capital or collateral against which claims can be made in case of default (Dusuki, 2008). According to Dusuki (2008), the essence of conventional profit-maximization banks as financial intermediaries providing financial services to people hinge upon two elements. As formal lenders, risk-averse banks would only willing to lend if these two elements serving as a basis of trust exist in their reciprocal relationship with clients (as borrowers). For instance, the bank is able to assess the reputation of borrowers based on bank's intimate knowledge embedded in the clients personal accounts as well as other documented history of past borrower behavior. At the same time, the clients have material value such as properties or any valuable asset serving as collateral to pledge against risk.

Another element that taking into consideration by the bank is "too poor" to save. Those elements make the poor has difficulty to access the credit from the bank. Therefore, this paper proposes a microfinance model to Islamic bank and use shariah compliant contract based on group lending to avoid moral hazard risk.

7. Microfinance Model

The most famous model up to date is the grameen bank model of microfinance that found by Muhammad Yunus in 1983 on principles of trust and solidarity. Muhammad Yunus - a Professor in Economics from the University of Chittagong, Bangladesh - has found a brilliant idea for the best solution in helping the poor out of their poverty, which then grows over the world. It initially began in Jobra, Bangladesh and later known as Grameen Bank, the largest bank in Bangladesh and probably the biggest micro credit organization in the world. Grameen Bank provides micro credit to the poorest of the poor in rural Bangladesh without any collateral. At Grameen Bank, credit is a cost effective weapon to fight poverty and it serves as a catalyst in the overall development of socio-economic.

Until 2002, Grameen Bank model has been replicated, either modified or kept original, by 400 replicators in 22 countries of Africa, 19 in Asia, 3 in Oceania, 15 in America, and 7 in Europe. This proves the successful of Grameen Bank as poverty alleviation program and has been internationally accepted by different countries and cultures. Remarkable achievements have been surprising. With mostly 100% of repayment record, the program has also been able to improve the life quality, provide better food, better education, as well as better housing for the poorer community.

Grameen Bank Replication (GBR) program in Indonesia was initially started in Bogor, West Java by Karya Usaha Mandiri (KUM) in 1989. This initiative was followed in 1993 by Mitra Karya East Java (MKEJ) in Malang, East Java. Both organizations have pioneered the GBR story in Indonesia as over 15 GBRs have taken part in different places in the country since 1997. In Sumatra, Grameen Bank model was replicated by Yayasan Pokmas Mandiri (YPM). Now YPM has 2 branches in 2 regencies (Deli Serdang and Asahan) that covers over 60 villages and purely operates as a sustainable micro-credit organization (Sarumpaet, 2005).

Some modification from the original Grameen Bank was made in according to the local culture and settings. Within 2 years, YPM had reached over 700 members and disbursed Rp. 320 million (approximately US$ 32,000) as micro-loan with 100% repayment rate. Recent coordination with international financing agency has also contributed a significant improvement the number of local micro enterprises getting financial capital and the amount of the loan given. The Citigroup Foundation has given a total grant of $190,000 for the program to four micro credit NGOs in Indonesia, including Yayasan Pokmas Mandiri (Sarumpaet, 2005).

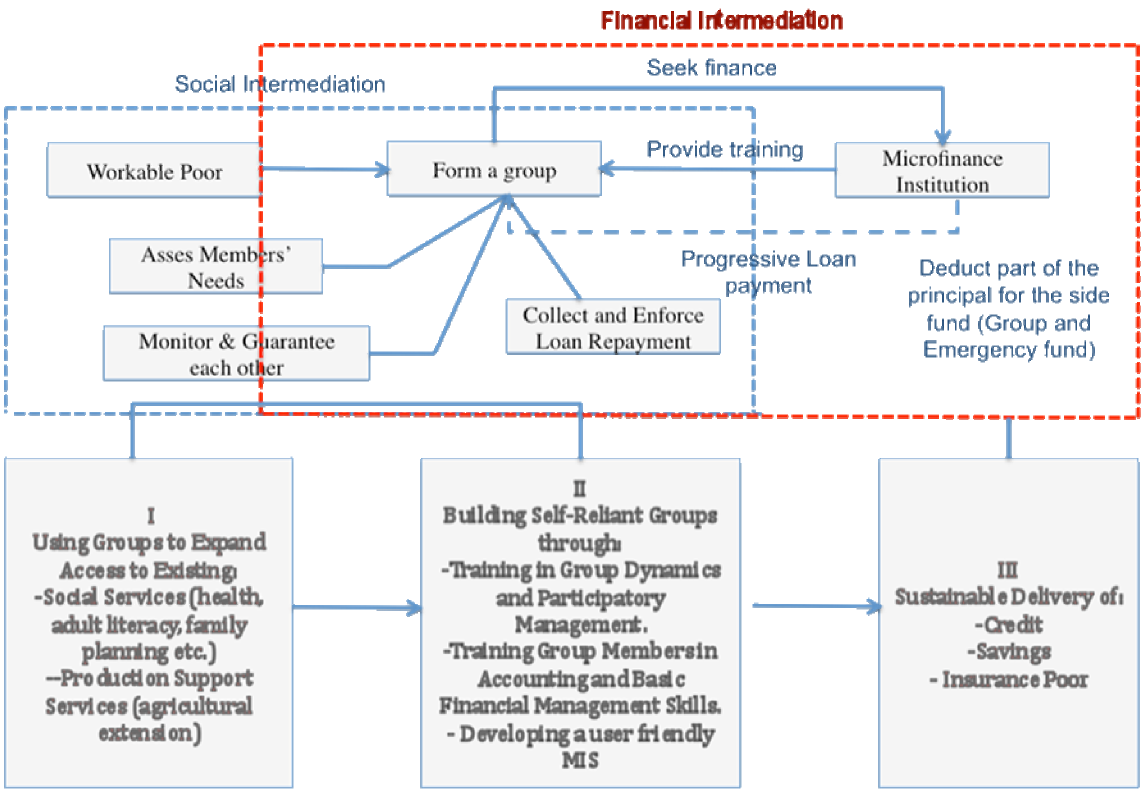
The failure of commercial banking to provide financial services to the poor is the major rationale why microfinance innovations have come into the picture needed to serve the poor. The most quoted examples are Grameen Bank, Koperasi unit desa of Bank Rakyat Indonesia, ACCION International in United States and Latin America and PRODEM, BancoSol's Predecessor in Bolivia (Dusuki, 2008). Consequently, in order to avoid many issues in microfinance scheme has to follow market-oriented and enterprise development approach that emphasizes institutional and programme innovations to reduce costs and risks. According to Dusuki (2008), there are some salient features of microfinance mechanism.

7.1. Integrating Social Intermediation

The traditional microfinance model cannot be utilized anymore since the issue of untrustworthy come to the picture. In the era of Prophet it can be done because Muslim at that time can be trusted and many companions come as guarantor to the lender. Since the time has change and many people naturally untrustworthy, the social intermediation needed to solve the moral hazard issue.

According to Dusuki, 2008; Benet et al., 1996; Pitt & Khandker, 1996) social intermediation is "a process in which investments are made in the development of both human resources and institutional capital, with the aim of increasing self- reliance of marginalised groups, preparing them to engage in formal financial intermediation". Social intermediation is different from other common types of social welfare services because it offers mechanism enabling beneficiaries to become clients who should then ready to enter into a contract involving reciprocal obligations. This aspect of social intermediation should eventually prepare individuals to enter into solid business relationships with formal financial institutions. The process normally involves training members in basic accounting and financial management as well as business strategy to ensure viability and sustainability of financial services offered. Figure 2 illustrates the social intermediation process in microfinance aiming to make groups to enter into solid business relationship (a contract involving reciprocal obligations) with formal financial institutions.

Figure 1. Social Intermediation Process



Sources: Combination of Dusuki, 2008, and Benet et al., 1996

7.2. Group-based Lending

Many successful microfinance institutions worldwide adopt group-based lending approach capitalising on peer monitoring and guarantee mechanism. Group-based approach normally involves the formation of groups of people who have a common objective to access financial services. One important feature of group-based lending is the use of peer pressure as a substitute to collateral. It has been proven empirically as one of the most effective ways of designing an incentive-monitoring system in the presence of costly information. Therefore its potential to reduce transaction costs in credit delivery and disbursements (searching, monitoring and enforcement) of the lender by shifting onto the groups.

Generally, the are three types of conventional microfinance (Dusuki, 2008); first, group-loan join liability, second, individual-loan join liability, third, individual-loan individual liability (current banking practice). The model that we proposed in this model is the second type of conventional microfinance, individual-loan join liability where the every group can choose their group member according to them in each region. Let say, in in Gombak Selangor we have Batu 4,5,6 or other area in Selangor or Kuala Lumpur in Malaysia conduct meeting every month. In each area we can asses for those who need loan for doing business, they can choose the member among its self 5 members, or we can broaden the region to have a group member in order to get financing from MF institution. The idea behind this model is basically to ease the member in choosing their group and usually they know each other.

7.3. Saving mobilization

According to Dusuki (2008), saving is crucial element in building self-sufficient microfinance institutions. Saving mobilization can strengthen microfinance institutions and reduce their dependence on government subsidies and donors for loanable funds. Well-crafted saving services can encourage a move from non-financial savings into financial savings, with advantages for entrepreneurs of safety and liquidity and for society of providing funds for investment by others. For example, Grameen Bank, Amanah Ikhtiar Malaysia and several programmes of ACCION International have used some form of compulsory savings, where borrowers are required to save a portion of the amount they borrow. The amount required for compulsory savings is sometimes determined based on a percentage of the loan granted or sometimes as a nominal amount. On the other hand BRI Unit Desa System in Indonesia offers a voluntary savings instruments such as passbook savings, with free access to deposits, which better meets depositors' liquidity requirements. The reason behind compulsory saving is to mitigate the moral hazard issue in MF institutions since there are many issues that currently happened in Indonesia whereby many BMT (one of Microfinance in Indonesia) suffered huge losses due to moral hazard problem.

7.4. In The Event of Default

The saving that we suggest is to put into reserve account, the purpose of this account to recover the amount of non-repayment financing in case of one or two members fail to obtain their obligation to pay their weekly payment obligation. Yet if there is no default from the group members, this account will be pass back to the original owner (group members) and treated this saving and *mudharabah* investment account. The profit from the investment will be distributed to according to profit sharing ratio.

However, if the reserve account does not enough to satisfy the repayment of financing and go bankruptcy, the Koperasi should responsible and gives all relevants report to Islamic Bank pertaining this issue and prove to Islamic Bank. The Islamic bank will investigate this issue whether there is no cooperation between Koperasi and group members in manipulating the information. At the end, the loss will be born by the Islamic bank as the risk.

In Addition, the model that proposed in this paper is developing microfinance model that has been emerged in the previous practices that basically non-shariah compliance activities and how do we apply it in Islamic context that appropriate for Indonesian culture through Koperasi. Basically, this model is to encourage Islamic bank to utilize Koperasi Concept in microfinance in order to smooth this idea. Look at figure 1.5

The basic mechanism procedures of applying the microfinance model via koperasi summarized as follows:

1.a Form a group. In order to get financing, there are should be five members in group whose form the group that they can trust each other. To ensure the cooperation, they are bound under underlying contract namely *Ta'awun*. Every member is responsible if there is default etc.

b. Approach Koperasi to get financing, so that Koperasi will report to the Islamic bank the group that want to get facility.

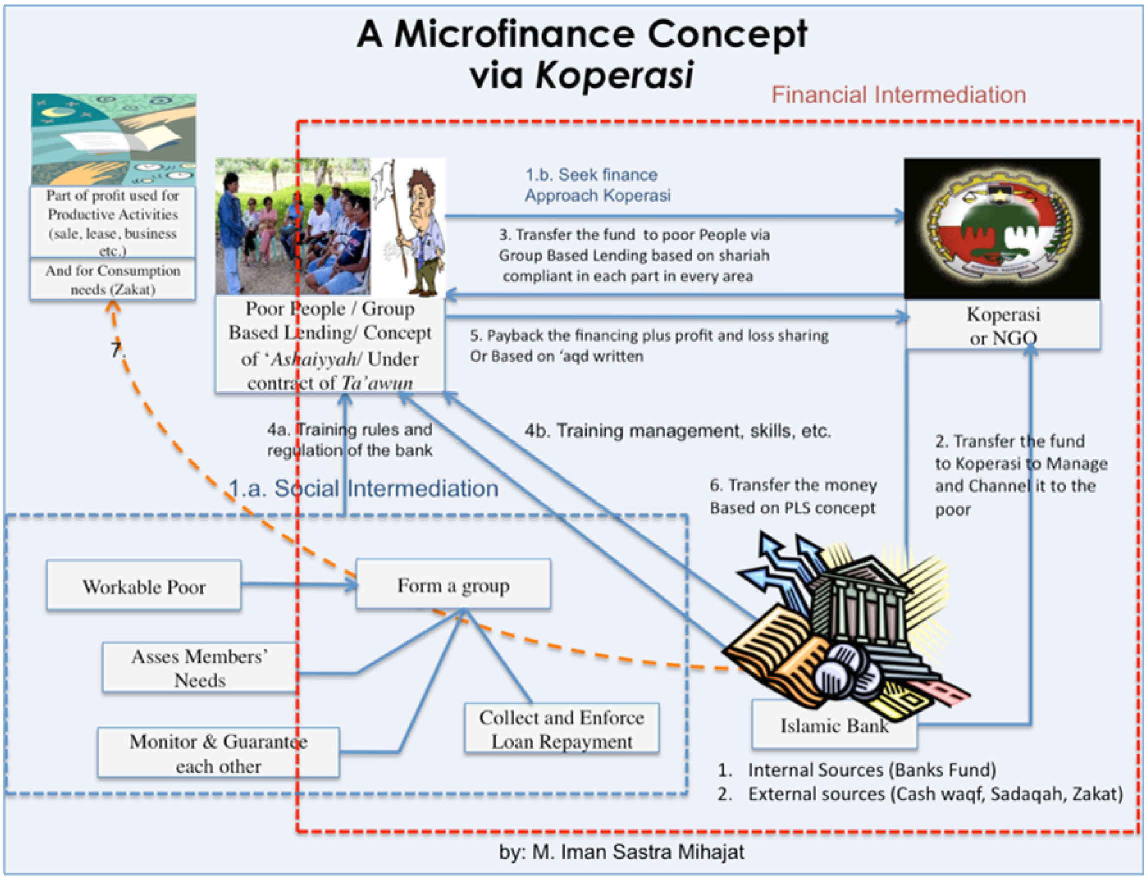
2. Islamic bank transfer the fund to Koperasi

3. Koperasi will transfer the fund to the group members and; 4. Islamic Bank will provide training regarding to management, skills etc. and training of rules and regulation of the bank

5. The group will pay back the principal plus the loss sharing profit to Koperasi and loss based on the agreement made and based on the contract used at front.

6. Koperasi will transfer the payment to the bank and; 7. Since part of the fund taken from zakat, sadaqah and waqf, the profit will shared into one for productive activities (refinancing), and part of it will distribute to the needy for consumption purposes.

Figure 5: A Microfinance Model via *Koperasi*



7.5 Concept of 'Ashabiyyah in This Model

The concept of 'Ashabiyyah that proposed in this model is basically the concept of solidarity that can strengthen the model of microfinance. The failure of commercial banking previously in lending money to the poor due to non-group based-lending structured with solidarity. Therefore, this model trying to combine all idea of successful microfinance model that is interest-based system into Islamic system which is free interest-based, free ambiguity, and free speculation.

Ibn Khaldun in his al-Muqaddimah postulates the necessity to have 'asabiyah in constructing a strong civilisation. 'Asabiyah or social solidarity or *'espirit de corp'* can be broadly defined as the state of mind that makes individuals to identify with a group and subordinate their own personal interests to the group interests. According to Ibn Khaldun, human being by nature is social being who prefer to live together, cooperate and helping each other. However, due to numerous worldly temptations and motivations, individuals sometime acting to serve their own self- interest, thereby undermining the interest of the society at large. In his writings, Ibn Khaldun asserts that 'asabiyah or social solidarity was more evidenced and much stronger in nomadic tribes. This is due the fact that nomads lead a very simple life and do not know anything of luxury (Dusuki, 2006).

Generally, there is main reason why the author integrated the concept of ‘ashabiyah in good manner in this model is to indoctrinate into the group member the solidarity of cooperation and helpful among them. While one of the froup member default in repayment, other group members will help in order to strengthen their financial rating in the bank. In Islam, the term ‘asabiyah is used to connote two different meaning. The first meaning identifies ‘asabiyah as a social solidarity which is in harmony with the concept of brotherhood in Islam. This type of ‘asabiyah is praiseworthy since it encourages people to cooperate with each other for common objectives, restraint their self-interest, and fulfil their obligations towards each other. The following Quranic verse attests to this:

> “*And cooperate in righteousness and piety, but do not cooperate in sin and aggression:* (Al-Quran 5:2)

The second meaning of ‘*asabiyah* is ‘*asabiyah jahiliyah* referring to the blind and prejudiced loyalty to one’s own group. This leads to the favouring of one’s own group, irrespective of whether it is right or wrong. This type of ‘asabiyah is blameworthy, having tendency to promote injustices, inequities, mutual hatred and conflict. The Prophet (p.b.u.h) made a clear distinction between these two types of asabiyah in a hadith:

> It was reported by Ibn Majah from the father of Fusaylah, that the Prophet, peace be upon him, was asked whether the love for one’s own qawm (group, ribe or nation) constituted under the meaning of ‘asabiyah. He replied: “No! ‘asabiyah is rather the helping of one’s qawm in zulm (injustice).”

There are many cases in Indonesia where Islamic microfinance has failed in financing the poor due to untrustworthy issue and microfinance model issue that not apply Grameen Bank’s model which is group-based lending. Currently, many microfinance institutions have been adopted Grameen’s model in lending money to the poor where they learn from historical failure of microfinance. Undoubtedly, Ibn Khaldun uses the word ‘asabiyah in the Muqaddimah to imply the positive ‘asabiyah or social solidarity strongly premised in Shariah. He asserts, social solidarity becomes an irresistible power if it is grounded on the religious paradigm. Hence a sense of solidarity of any group or tribes can only make a real impact if supported by religion and not otherwise (Dusuki, 2006).

7.6 Barrier in This Scheme

The experiences of default (moral hazard) of microfinance in the globe is one of the reason why many either Islamic bank or conventional bank reluctant to support the businesses of poor. Hence the financing objective in this model to finance and cooperate with the poor in their business activities, good governance and management is urgent in this model.

The essence of the existence of bank is to maximize profit and reduce cost, financing the poor is costly to the bank and the risk is high, these are other issues in microfinance. Therefore, Islamic bank as entity who promote shariah compliant products should undertake this financing through koperasi who has experiences in microfinance in Indonesia to work together by using this Islamic microfinance model.

There are barriers in this model; *first*, the issue of when koperasi does not recognized very well the group are they have the capability to get the financing and the business proposed is the real business or just manipulation to get personal loan for personal expense not for businesses. *Second*, the issue of cooperation between koperasi and group members to manipulate the proposal to get financing. Therefore, the bank should asses and analyze the proposal very well before imbursement of the loan to avoid misuse of the fund. *Third*, when there is default from group members, who are going to take responsibility? In this case, the duty of koperasi is to report to the Islamic bank why this group members default. If the default because of the negligence of the group members, the Islamic bank should give time and charged penalty, this penalty payment will be channel in to charity. If it is because of natural disaster faced by the group, Islamic bank should set off the loan and recognize it as zakat and sadaqah for them from zakat and sadaqah fund. Fourth, the issue of less skill in the group members, therefore we proposed training fro the group member in order to assist the run of this proposal.

7.7 Contracts in Microfinance Scheme

Generally, many ‘aqd that can be used by Islamic bank in microfinance concept as follows:

Category	Instrument	Description	Application
1. Participatory-based	Musharakah	A partnership contract between two parties who both contribute capital towards the financing of a project. Both parties share profits on a pre agreed ratio, but losses are shared on the basis of equity participation. Either parties or just one of them may carry out management of the project. This is very a very flexible partnership arrangement where the sharing of the profits and management can be negotiated and pre-agreed by all parties.	This financing mode is suitable for working capital financing, fixed asset purchased, project financing, etc.
	Mudharabah	An agreement made between two parties: one which provides 100 per cent of capital for the project and another party known as a *mudharib*, who manages the project using his entrepreneurial skills. Profits are distributed according to predetermined ratio. Any losses accruing are borne by the provider of capital. The provider of capital has no control over the management of the project.	This financing mode is suitable for working capital financing, fixed asset purchased, project financing, etc.
2. Exchange-based (*mu’awadhat*)	Murabahah	A contract sale between the bank and its client for the sale of goods at a price which includes a profit margin agree by both parties. As a financing technique, it involves the purchase of goods by the bank as requested by the client. The goods are sold to the client with a mark-up. Repayment, usually in installments is specified in the contract.	This financing mode is suitable for working capital financing, fixed asset purchased, project financing etc.
	Bay` Bithaman ‘Ajil	This contract refers to the sale of goods on a deferred payment basis. Equipment or goods requested by the clients are bought by the bank which subsequently sells the goods to the client at an agreed price which includes the bank’s mark-up (profit). The client may be allowed to settle the payment by installments within a pre-agreed period, or in a lump sum. Similar to a murābahah contract, but with payment on a deferred basis.	This financing mode is suitable for working capital financing, fixed asset purchased, project financing etc.
	Bay` al-Salam	A contract of sale of goods where the price is paid in advance and the goods are delivered in the future.	This financing mode is suitable for agricultural financing which requires capital at certain critical stage (e.g. during plantation stage).

	BBay` al-Istisna'	A contract of acquisition of goods by specification or order, acquisition of goods by specification or order, where the price is paid in advance, but the goods are manufactured and delivered at a later date.	This financing mode is suitable for financing assets which require capital at different stages of construction and tailor-made manufacturing.
	Ijarah	A contract under which a bank purchases and leases out equipment required by its clients for a rental fee. The duration of the lease and rental fees are agreed in advance. Ownership of the equipment remains in the hands of the bank.	This instrument is suitable for financing fixed assets such as machinery, motor vehicles etc.
3. Voluntary charitable contract (*tabarru`*)	*Ar-Rahn*	A pawning contract which involves holding a valuable non-fungible good as insurance against a debt, where the non-fungible may be used to extract the value of the debt or part thereof. In some jurisdiction, a minimum custodian fee may be charged to the borrower for safekeeping of pawned property	This financing mode is suitable for all purposes including working capital, personal consumption, fixed assets purchase etc. This mode of financing requires customer to have valuable asset eligible for pawning such as gold or silver.
	Qard al-Hassan	An interest-free loan given mainly for welfare purposes. The borrower is only requires to pay back the amount borrowed. In some cases, a minimum administrative fee may also be charged to the borrower. However this service charge must be the actual administrative cost incurred in managing the loan and not a fixed percentage on the amount of loan.	This financing mode is suitable for all purposes including working capital, personal consumption, fixed assets purchase etc.
4. Hybrid	*Musharakah Mutanaqisah*	This instrument involves three different contracts, namely musharakah, sale and ijarah. Islamic banks jointly purchase and own an asset with client aiming at transferring the ownership to the client. The bank's share will gradually be reeemed by client by executing sales contract. The bank is also allowed to lease its portion of the asset to client for rental income.	This financing instrument is suitable for fixed asset financing.
	Ijarah Thumma al-bay`	This instrument involves two separate contracts namely leasing and sales contracts executed separately and in sequence. The bank normally purchases the asset and leases it to client. At the end of leasing period, the ownership is transferred to the client by executing sales contract which normally at a nominal price.	This financing instrument is suitable for fixed asset financing such as motor vehicles.

Source: (Dusuki, 2008)

In addition, there are many contracts that we can utilize for this model depend on the need of entrepreneur and Islamic bank. Since the contract is not limited, the microfinance model via koperasi is more acceptable and relevant to use in the current system. If it is business activities, we can use *mudharabah* and *murabahah* that based on profit and loss sharing, whereby the loss born by capital provider and profit disbursed depend on agreed ration among parties. For agriculture purposes we can use *salam*, where the payment in advanced where the commodity will delivered in the future in agreed price and agreed types of commodity and so on.

8. Conclusion

This paper introduces the relevance of Islamic microfinance concept via *Koperasi* to utilize by Islamic bank in Indonesia that can be accepted also globally by using NGO as intermediary between group members and the bank. This microfinance bound under shariah compliance contract in mobilizing the fund that promotes financing activities to the poor. The workable poor are potential clients that can generate profit for the bank and generate profit for the bank that can increase economic growth of the country. One the poor can be decreased from time to time using this model, the prosperity of the *ummah* will taken place. Introducing Islamic microfinance is to promote social justice in the society and equal distribution of wealth at same time prohibiting illegal activities that can destroy social and environmental well being is constrained in this model.

The model in this paper has been discussed its salient features, first; the concept of group based lending that is one of the most successful microfinance concept as a globally accepted to be practiced by Islamic bank. In the group based lending, we train the members to become '*ashabiyah* to each other under contract *ta'awun* where each members will responsible with any issue happened among them and cooperate in the time of profit and loss. Second; the purpose of using Koperasi as intermediary between group members and the bank is to reduce the cost. The bank does not need to open the branches in the urban area that can increase the administration cost and other cost. Third; training for the members is very urgent in this financing, many microfinance institutions failed due to lack of skills of group members and less educated. Thus, the task of bank is giving training regarding to the relecant skills and management of business and also regulation of the bank to improve their ability.

As far as the poor are being concerned, they should perceive formal savings, credit and financial services as safer and more attractive (Obaidullah and Khan 2008). Formal saving by group members also one of risk mitigation instrument that can be used by Islamic bank. However, the primary goal of this model is to develop a microfinance industry that is institutionally and financially sustainable and integrated within the broader formal financial sector that respects the cultural and religious values of a Muslim society. This model seen as an essential tool and approach for poverty alleviation and soci-economic development in Muslim countries.

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