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Islamic Economic Orientation Model for Microfinance Institution

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Abstract

This study formulated a model of Islamic economic orientation towards microfinance institutions (MFIs) in Solok Indonesia. The approach method used is Participatory Action Research (PAR) on Islamic economics in social change. This study produces three models of Islamic economic orientation, namely social, profit and social-profit. Thus, this research helps the community in implementing a more reliable Islamic economy.

Keywords: Islamic economics; Micro finance institutions (MFIs); Participatory action research (PAR); Orientation models, Social-profit.



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1. Introduction

Trade and services are the economic fields of the people of Solok which made the biggest contribution, that is 25.69% of the Gross Regional Domestic Product (GRDP) in 2016. As a large part of this sector comes from the micro economy (small) which is 88.65%. Thus, this sector must be supported by the real sector in providing capital. Currently there are various capital providers, including 10 units of Agribusiness Microfinance Institutions (AMFI), 35 units of Joint Business Groups (JBG), 30 units of Baitul Mal Wattamwil (BMT), and 68 units of Cooperation (Solokkota).

Microfinance Institutions (MFI) have an important role as intermediary institutions that connect capital owners with those who need capital. MFI are institutions that provide financial services to micro-entrepreneurs and low-income communities, formal, semi-formal and informal (Jan *et al.*, 2018; Supanggih and Widodo, 2013). This is a fundamental problem, especially in countries with a Muslim-majority population, where 75% of the population does not have access to formal financial institutions (Mohseni-Cheraghlou, 2017). The MFI has two main objectives to be achieved, namely financial and social development of the community (Almobaireek *et al.*, 2017; Widiarto and Emrouznejad, 2015).

In general, in Indonesia only 20% of people have a level of literacy towards financial institutions (Kardinal, 2015). In addition, people are able to create their own capital requirements from informal capital sources based on different and unique cultural influences in each region (Abdullah and Ismail, 2017; Wulandari *et al.*, 2016). However, this source of informal capital is not able to operate optimally due to limited human resources (HR), management, information technology and capital capabilities. In management, human resources need to be included in all business processes with low costs (Daneshjo *et al.*, 2017). Merging business management with information technology will have an impact on managerial improvement (Valkokari *et al.*, 2018). If not, the community will look for other capital providers, such as moneylenders, who make the community fall into high rates of return.

Nowadays, the Islamic economy has become a serious concern by the Solok Government. The government makes Islamic economics an integral part of its long-term vision by targeting assets of 10% of national banking by 2020. 98.7% of the public approves the establishment of Islamic banks and 95% of them wish to utilize it. Thus, there is a high level of public trust in the Islamic economy (Pourmola *et al.*, 2019).

Islamic economics applied in the MFI model is Microfinance Institutions Islamic (MFII). The working principle of MFII is almost the same as that of a conventional MFI (Tamanni and Liu, 2017), but there are different in contract and transaction. The main difference is on the interest. In business financing, revenue and profitsharing systems are used with Mudharabah, Musharakah, Murabahah, Ijarah, and Qard al-hasan models (Mansori *et al.*, 2015). MFII activities contribute to achieving fair income distribution, increasing social mobility, achieving broad-based financial inclusion, and encouraging fulfillment of needs (Shaikh *et al.*, 2017).

Dusuki (2008), conducted an Islamic economic research, in reviewing microfinance schemes that can participate in the sustainability and sustainability of MFII urgently needs an innovative approach beyond the role of traditional financial intermediaries, such as building human resources through social intermediation and designing group-based loan programs as a tool effective to reduce the risk of the rural poor. El-Komi and Croson (2013), found a higher level of compliance with MFII by sharing results and joint ventures rather than interest-based. Hassan (2014), found that collective action in the MFII was very successful in helping to increase environmental awareness, improving member economies and managing local resources. Furqani (2015) and Wahbalbari *et al.* (2015) emphasize the MFII based on the principle of Islamic solidarity.

The advantages of Islamic economics are the drivers of financial inclusion in communities with a very large Muslim population (Hasnat and Salleh, 2018). Islamic finance is a strategic partner in the development of micro businesses (Efendić and Hadžić, 2017; Mahmood *et al.*, 2017). But these advantages are faced with many problems, such as low knowledge and adherence to Islamic principles and low financial policy instruments that are able to support well (Rahman and Dean, 2013). The need for education and training facilities, better coordination and networking, technical assistance through waqf and zakat funds Nurzaman (2017), and the development of a regulatory and policy environment. The challenge to this problem is in desperate need of a framework for development and integration in financial sector development policies (Yas *et al.*, 2018). For this reason, this research was carried out in formulating a model of Islamic economic orientation towards microfinance institutions.

2. Material and Method

The source of data in this study was the MFI of Solok Indonesia. There were two kinds of data, namely primary and secondary data. Primary data was obtained using the Focus Group Discussion (FGD) method and verification of field data. FGD implementation involves stakeholder elements that are considered relevant. Stakeholder provides data related to the preparation of the MFII development design by verifying the condition of the MFI. This data was processed by using descriptive methods.

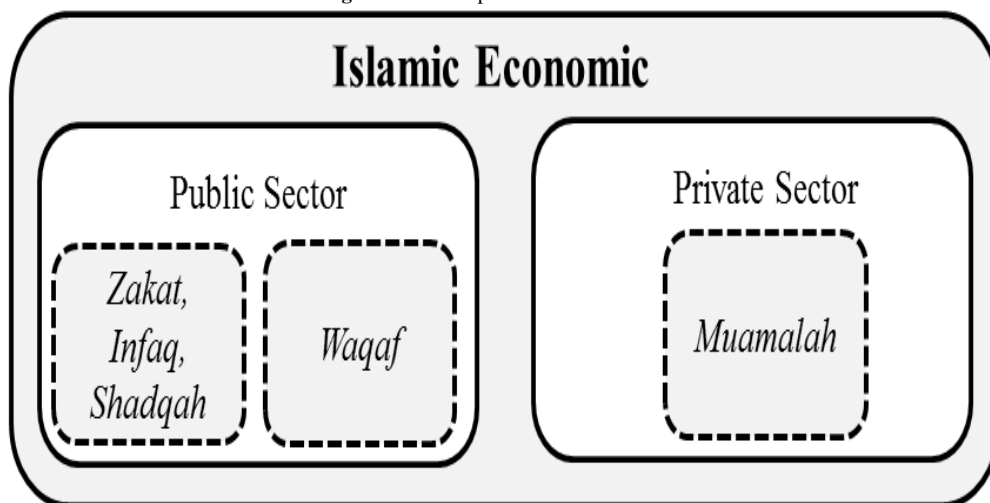
Secondary data comes from documents supporting the implementation of MFI activities. This supporting document is obtained from the Central Statistics Agency, the Regional Long Term Development Plan, and the Regional Medium Term Development Plan from each Regional Device Organization. Secondary data was processed by using descriptive statistics in tabulation form and presented with descriptive analysis.

Participatory Action Research (PAR) method was used in this research. PAR is an approach in finding the relationship between the research process and social change. Illustration of PAR relevance is highly developed in research projects to process data based on time and place (Ngwenya, 2018). Social change consists of empowerment that can realize three types of benchmarks in society, namely commitment, local leaders and new institutions built on needs. Empowerment must also be built by incorporating social personality elements (Stavreva-Kostadinova, 2018). Businesses institution can be efficiently developed and institutionalized at a wider level on their peculiar by social practice (Khan, 2016).

3. Results and Discussion

The scope of the Islamic economy consists of private and public sector. In the private sector is about personal relationships between communities and the public sector is about the national development. In general, the scope of Islamic economics can be seen in Figure 1.

Figure-1. The scope of Islamic economics



The instrument used in the public sector is zakat, waqaf, infaq and shadaqah. In national development, regulations for zakat, infaq, shadaqah and waqaf have been regulated by law by the Government of Indonesia. The existence of this law is a tangible form that Islamic economic instruments in the public sector have received serious attention from the Government of Indonesia. But the existence of this regulation has not been managed maximally in realizing the potential of zakat as a driver of national development.

However, in the private sector the orientation model is designed. The orientation model produced in this study consists of 2, those are; the implementation model and the concept model. Both models are described in the following sub-sections.

3.1. Implementation Model

The implementation model is the provision of facilities in implementing Islamic economics. This model will produce a real impact on the community. The implementation model consists of social orientation, profit orientation, and a combination of social orientation with profit.

3.1.1. Social Oriented

This model is implemented in institutions that distribute funds from non-profit sources. This model orientation is carried out for poverty alleviation using a revolving fund scheme.

Pre-requires:

- Focus on social programs.
- The target to enliven the mosque was expanded to become the target of the fakir / poor / dhuafa (FMD).
- Use qardhul hasan agreement or new contracts.

Pattern:

- Partnership with non-profit institutions,
- Partnership with the Partnership and Community Development Program of State-Owned Enterprises.
- Poverty alleviation program in the Amil Zakat Agency.

3.1.2. Profit Oriented

This model aims at business profit, which maximizes income for member prosperity.

Pre-requires:

- Having a solid membership base.
- Measured business plan.
- Professional management.

Pattern:

- Channeling partnership with Corporate Social Responsibility (CSR) programs.
- Linkage with banks.

Government programs with specific objectives.

3.1.3. Profit with Social Oriented

This model is the management of social funds by incurring costs, so that it can help members who also benefit the institution.

Pre-requires:

- Having a solid membership base.
- Professional management.

Pattern:

- Partnership of non-profit institutions for social purposes.
- Business linkage with CSR fund suppliers.
- Micro sector banking for profit targets.

3.2. Concept Model

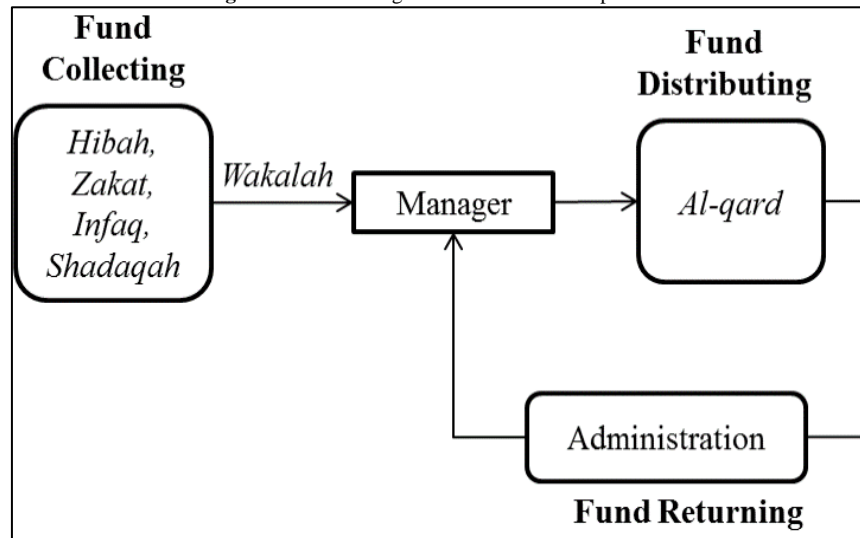
Concept model is a relationship between certain factors that will have an impact on goals. The concept model provides a theory that can be used in MFII. The purpose of this concept model is to help represent a MFII, so that it is easier to achieve results that actually occur (real). The concept model consists of 3, namely the social concept model, the profit concept model, and a combination of social concept models with the profit concept model.

3.2.1. Social Concept Model

The social concept model is a socially oriented model. Management in this model can act as a representative of the funder (muwakil). The contract used is the wakalah contract. MFII used are called Baitul Maal wa Tamwil (BMT).

Wakalah is the transfer of power by someone as a first party to another person as a second party. Representatives to the second party only carry out activities limited to the power or authority granted by the first party. If the power of attorney has been carried out as required, then all risks and responsibilities are fully the first party or authorizer. In the wakalah contract, a representative can get compensation for his services based on an agreement with the capital owner. The social concept process diagram is presented in Figure 2.

Figure-2. Process diagram of the social concept model

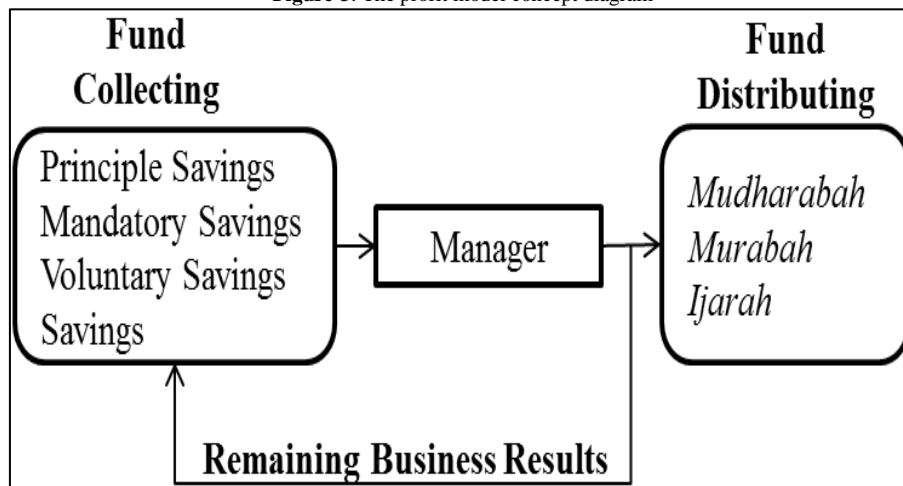


The contract used in the distribution of funds is a qardh contract (al-qardh). Al-qardh is a loan that is given to customers (muqtaridh) who need it. The customer of al-qardh is obliged to return the principal amount received at a mutually agreed time. Administrative costs are charged to customers. BMTs can request guarantees to customers if deemed necessary. The customer of al-Qardh can voluntarily contribute to BMT as long as it is not agreed in the contract. If the customer cannot return part or all of his obligations at the agreed time and the BMT has acknowledged his incompetence, then it will extend the repayment period or write off part or all of his obligations.

3.2.2. Profit Concept Model

The profit concept model aims to achieve profits. In this model, MFIs are legally incorporated as cooperatives so that funds are collected from deposits and savings. Savings used are mudaraba and wadiah principles and there is no interest calculation. Mudharabah provisions are transactions against customers acting as shahibul mal or fund owners and MFII acts as mudharib or fund manager. The MFII used is Cooperation. The profit concept model diagram can be seen in Figure 3.

Figure-3. The profit model concept diagram



Cooperation as a mudharib can do various kinds of business that are not in conflict with Islamic principles. Cooperation can develop businesses, such as mudharabah with other parties. The capital must be deposited in cash and non-receivable. Profit sharing must be stated in the form of a ratio stated in the account opening contract.

Operational costs are charged to savings savers using the profit ratio that is the right of shahibul mal. Cooperation is not permitted to reduce the profit ratio without the relevant consent. While, wadiah deposits can be taken any time or by agreement. There is no reward, except in the form of giving (athaya) which is voluntary from the cooperation.

In profit there are three contracts that can be developed namely murabahah, ijarah, and mudarabah. The concept of murabahah is a concept of financing carried out by cooperation with free interest free. The conditions are the goods that are traded and not prohibited by Islamic. The cooperation finances the purchase of members' goods by setting the cost and margin agreed with the members. The cooperation finances a part or the entire purchase price of the item that has been agreed by the qualification. The cooperation buys the items of customer needs on behalf of the cooperation itself, and this purchase must be legal and interest free.

The cooperation must submit all matters relating to the purchase, both in cash and debt. The cooperation then sells the item to the customer (ordering) with the selling price of the purchase price plus the profit. In transactions, cooperation must honestly inform the cost of goods to the customer and the costs required. Member pays the agreed price of the item at a specified time period. To prevent misuse or damage to the contract, the cooperation can enter into special agreements with members. In another concept this murabahah contract can be combined with a wakalah contract called wakalah wal murabahah.

Wakalah wal Murabahah is a cooperation and the member has agreed on the item to be purchased, but the limited time that is owned by the cooperation employee then the employee represents the purchase to the members of the cooperation by providing financing assistance to the customer. In this murabahah concept, the profits obtained by the cooperation come from the margin or percentage of profits agreed between the cooperation and members.

The ijarah model is a service provided by cooperation to members and users of cooperation facilities which gives rise to ujroh (wages) as an income for cooperation. The object of ijarah is the benefit of the use of goods and / or services. The benefits of goods or services must be assessed and can be carried out in a contract. The benefits of goods or services must not be prohibited. The ability to meet benefits must be real and in accordance with Islamic. Benefits must be specifically identified in such a way as to eliminate jahalah (ignorance) which will result in a dispute. Benefit specifications and transaction period must be clear. Rent or wages is something that is promised and paid by the customer to the cooperation as a benefit payment.

Mudharabah is the concept of cooperation between cooperation and members who act as financiers and managers with a profit sharing system agreed upon jointly. Mudharabah financing is financing distributed by cooperation to members for a productive business. In this financing cooperation as shahibul maal (fund owners) finance 100% of the needs of a project (business), while members (customers) act as mudarib or business managers. The business period, the procedure for refunds, and the distribution of profits are determined based on the agreement of both parties (cooperation with customers). Mudharib may carry out various types of business that have been mutually agreed up on and in accordance with Islamic. Cooperation may not participate in company or project management, but have the right to conduct guidance and supervision.

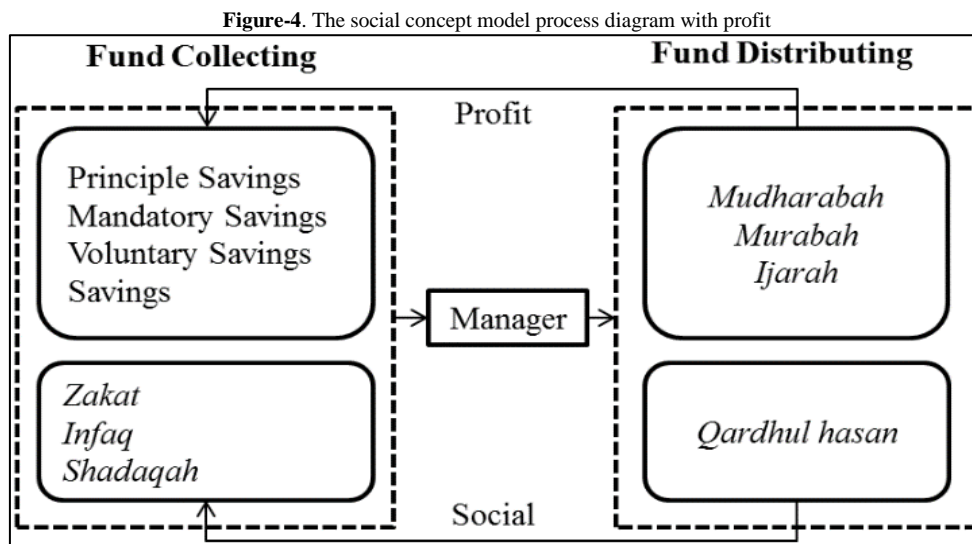
The amount of financing funds must be clearly stated in cash and non-receivable. The cooperation as a provider of funds bears all losses due to mudharabah except the mudarib (the customer) makes a deliberate, negligent, or violating agreement. In mudharabah financing there is no guarantee, but to avoid irregularities can be guaranteed from mudharib or third parties. This guarantee can only be disbursed if the mudarib is proven to have violated the things agreed upon in the contract.

Employers' criteria, financing procedures, and profit sharing mechanisms are regulated by the cooperation by taking into account the fatwa of the National Islamic Council. Operational costs are charged to mudharib. If the cooperation does not carry out obligations or violates the agreement, the mudharib has the right to get compensation or costs that have been incurred. The results obtained by the cooperation from this concept are the profit sharing from the profits derived from the business carried out.

In the final order all the calculation of profits obtained by the cooperation will be reduced by operational costs and other expenses so that remaining business results will be obtained. This remaining business results will be distributed by cooperation at the end of the year as an effect received by customers who are members of the cooperation.

3.2.3. Profit Concept Model

The social concept model with profit is the collection of funds owned by BMT not only limited to zakat, infaq and sadaqah, but also comes from members' savings compulsory, principal and voluntary as well as savings. In this concept, BMT is directed to become a legal entity for cooperation so that there is accumulation of funds from savings and savings. Savings and deposits have no interest calculation. Savings must be based on mudharabah and wadi'ah principles. The social concept model diagram with profit can be seen in Figure 4.



Mudharabah savings are customers acting as shahibul mal or fund owners and BMT acts as mudharib or fund manager. BMT can do various types of business that are not contrary to Islamic principles. BMT can develop it with mudharabah on the other side. The capital deposited must be in cash and non-receivable. Profit sharing must be stated in the form of a ratio and set forth in the savings opening agreement.

BMT as mudharib can use the profit ratio which is its right in financing its operations. BMT is not permitted to reduce the profit ratio of the customer without the relevant consent. While wadiah deposits choose properties that can be taken at any time (on call) or based on an agreement. There is no compensation arrangement, except in the form of voluntary giving ('athaya) from BMT.

In the distribution of funds there are two orientations made by BMT, namely social and profit. For social as well as in the first model of the contract that was developed, namely the al-qard contract with the addition of administrative costs to the customer. With this contract the social goals of BMT can be done in order to help the community like the first model. Whereas in profit there are three contracts that can be developed namely murabahah, ijarah, and mudharabah.

4. Conclusion

This study produced 2 MFII orientation models, namely the implementation model and the concept model. Each model is grouped into 3, those are social orientation, profit and social combination with profit. Each of these orientation models will benefit all parties involved in the MFII and will not be detrimental if carried out in accordance with the rules agreed to in accordance with the Islamic. For this reason, this orientation model is a benchmark in the social and business life of the community in the future and anywhere. MFII supported by information technology will be able to overcome problems in implementing this orientation model later.

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