

SHARIA MICROFINANCE INSTITUTION BUSINESS MODELS IN INDONESIA

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ARTICLE INFO

Keywords:
Islamic Microfinance
Institutions
business models
social function

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ABSTRACT

Islamic Microfinance Institutions (MFIs) have grown very rapidly in the last 10 years in Indonesia. In 2015, the number of IMFI reached more than 5,000. As a business and social entity, IMFI has various business models, ways of providing services and managing business to achieve its goals. This study aims to determine IMFI's business model. Methodology/Technique – This study used a qualitative approach using the Robert K. Yin case study technique. The subject of this research is IMFI in Indonesia which was selected purposively with the manager as the key informant. Findings – The result is that the IMFI business model is determined by eight elements, namely: organizational orientation, business and social functions, sources of capital and allocation, investors and customers, use of financing, types of contracts, allocation techniques, and membership. Novelty – The elements that determine IMFI, will form the IMFI business model that determines how IMFI carries out its business activities to achieve organizational goals.

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1. INTRODUCTION

Since its establishment in 1990, Islamic Microfinance Institutions (MFIs) have grown rapidly. Thousands of IMFI operate in many rural and urban areas in Indonesia. The government responded to this phenomenon by issuing Decree of the Minister of Cooperatives and SMEs No. 91 of 2004 concerning Operational Permits for the Establishment of Islamic Financial Services Cooperatives (KJKS). Since then, thousands of Islamic cooperatives have sprung up in Indonesia. Regulation of the Minister of Cooperatives and Small and Medium Enterprises No. 16 of 2015 provides reaffirmation of sharia cooperatives under the name Sharia Savings and Loans and Financing Cooperatives (KSPPS).

As a business and social institution, IMFI has various business models to achieve its goals. A business model is the overall business logic that is applied to relationships with customers, value chains, resources, operational management, revenue or profit generation, and business entity sustainability. According to Osterwalder and Pigneur (2010), a business model can be defined as a conception of a set of elements that enables a company to implement its business logic in one corporate architecture with its network. This architecture consists of production, marketing, and certain awards to customers so that it will generate a sustainable stream of income (Hendratmi, 2016). Thus, the business model describes the concept of how a business organization can create value, both economic, social and other forms of value and manifest it in the business as a whole. Some of the important things that distinguish the entity's business model are the underlying value system and business design in achieving its goals. As a financial institution that has business and social functions, Islamic cooperatives have their own business model. In terms of value, sharia cooperatives are inseparable from Islamic values in all of their operations. In terms of interests, Islamic cooperatives can focus on business, focus on social functions, and among others. Likewise in terms of capital, many sharia cooperatives rely on capital from members, but most rely on outside capital. The focus of financing also varies. Most sharia cooperatives only focus on members, but some also focus on external parties or the community. Financial goals, capital and targets are some of the indicators that will determine the Islamic cooperative business model. This study attempts to explore these indicators and analyze the business model of Islamic cooperatives in Indonesia.

2. LITERATURE REVIEW

2.1 Islamic Finance

Islam obliges every Muslim to fully embrace Islam (Qur'an 2: 208), including in his economic and business activities. One of the rules in the practice of Islamic economics and business is the prohibition of usury (Qur'an 2: 275). The scholars claim that the interest (usury) charged by financial institutions, such as banks, insurance companies, cooperatives, and so on, is included in Islam as *riba*. Fiqh scholars equate (*qiyas*) interest with usury because interest has characteristics similar to usury (Antonio, 2001). The prohibition of interest is a consequence of the substitution model of modern financial intermediation that is not based on interest. Chapra (2001) mentions substitution is the use of own capital (equity) and a little credit consisting of a combination of primary and secondary modes. The main mode of reimbursement of interest in this financial intermediation is a profit-sharing system, namely *mudharabah* (passive partnership) and *musyarakah* (active partnership). While the secondary mode is buying and selling (*murabaha*, *salam*, *istishna*) and rent.

According to Chapra (2001), a profit-sharing system through *mudharabah* and *musyarakah* must be the main feature of Islamic financial institutions. Because the profit-sharing system provides fair profits and losses. If the profit is high, the owners of capital and managers will get high profits. This scheme must also be applied to losses (Ryandono, 2009). In addition, the profit sharing system is more in accordance with sharia compared to *murabaha* and *ijarah*. Thus, sharia cooperatives must comply with sharia rules, both the institution, its management, and the contract used. As a sharia financial intermediary institution, sharia cooperatives are required to practice sharia-compliant contracts in intermediation activities, namely the funding and financing of these funds. Compliance with sharia is not only from a fiqh point of view, where the contract used is not only in accordance with sharia provisions but also the substance for which sharia is enacted. According to the *fuqaha*, the ultimate goal of all rules or implementation of sharia is to achieve *maqasid sharia*, which in essence is *maslahah*. Al-Qaradawi (2006) says that the purpose of shari'a is the wisdom of implementing shari'a. It is explained that the wisdom of every rule is a mercy for mankind (Qur'an 21: 107). The Prophet Muhammad was sent on purpose: "We have no intention of sending you (Muhammad), but blessings for the whole world". Mercy for all nature in the hadith is defined as the benefit of the people. The scholars agree that indeed Islamic law contains benefits.

Thus, all Islamic financial institutions are not allowed to use interest as an instrument in providing compensation to depositors and it is borne by borrowers. Apart from interest, Islamic financial institutions must also avoid *maysir*, *gharar*, unclean products and mechanisms, and injustice (Mawardi, 2015).

2.2 Islamic Microfinance Institution (IMFI)

One of the sharia financial institutions that performs financial intermediation in Indonesia is the Islamic Microfinance Institution (IMFI). According to the Regulation of the Minister of Cooperatives and SMEs No. 16 of 2015, IMFI is a cooperative that organizes savings and loan activities and financing with a sharia pattern called the Savings and Loans Cooperative and Sharia Financing (KSPPS). In accordance with the Regulation of the Minister of Cooperatives and SMEs, KSPPS has businesses and social activities including savings, loans and financing according to sharia principles, management of *zakat*, *infaq*/*alms*, and endowments. The Islamic principle in question is the principle of Islamic law in cooperative business activities based on a fatwa issued by the National Sharia Council of the Indonesian Ulema Council (DSN-MUI). Thus, all cooperative operations must comply with sharia fatwas from the National Sharia Council or what is known as the MUI. As a cooperative, IMFI is a closed intermediary institution, which accepts deposits and distributes financing under Islamic Sharia compliance agreements only to cooperative members. In addition, as a business organization that is also a social institution, IMFI can receive and distribute *zakat*, *alms* and *infaq*, and manage *waqf* assets. IMFI in Indonesia has adopted the *Baitul Maal wa tamwil* concept, namely as a business institution (*baitul tamwil*) and a social institution (*Baitul Maal*) (Hamdan, 2014).

According to Hamdan (2014), as a business organization, Islamic microfinance performs a financial intermediary function. The IMF accepts deposits in the form of deposits, mandatory savings, voluntary deposits, and deposits that are equated with mandatory deposits with sharia contracts. The contracts used are *wadiah* and *mudharabah*. IMFI provides loans to members using Sharia compliance agreements, namely *murabaha*, *salam*, *istishna*, *Ijara* and *Ijara Rompiiya bi Tamlik*. As a social institution, Islamic cooperatives can take the form of *amil zakat*, *infaq*, and *alms*. IMFI receives and distributes to those who are entitled. In addition, the IMF can also become a *nadzir* or *waqf* manager. According to the Ministry of Cooperatives and SMEs, the number of sharia cooperatives in Indonesia in 2010 was 3,307 with assets of

Rp 3.6 trillion. In 2015, the number of sharia cooperatives increased to more than 5,000 with assets of more than IDR 4.7 trillion. Most sharia cooperatives have many branches to provide services to members and communities in various villages and cities (Hasbi, 2015).

2.3 Business Models

One element of business in the perspective of real practice is a business model. A business model is the overall business logic that is implemented together with the customer, which includes the value chain, sourcing, operational management, to the design and sustainability of the business entity's revenue or profit. According to Osterwalder and Pigneur (2010), a business model is a conception of a set of elements that enable companies to appreciate the business logic within a single enterprise architecture and its network. This architecture includes production, marketing, and provision of value to customers resulting in a valuable and sustainable revenue stream. The business model describes the concept of how a business organization can create value, whether economic, social, or other forms of value, and realize the business as a whole. Based on this concept, business models require important instruments, namely value systems that underlie business entities, and business designs to achieve goals. Currently there is no consensus on the mutually agreed definition of a business model. Similarly, there are various definitions and formation elements. Various business models have been developed.

According to Hendratmi (2016), most business models have various constituent elements which of the whole business model have the same elements: 1) the value offered (create value), 2) the economic model; 3) relationship with customers; 4) network; 5) internal infrastructure and 6) target market. Most significant to the business model is the relationship between revenue and costs that generates profits. The emphasis on costs will determine the amount of profits and profits generated. Although value creation is the main soul, two important pillars, namely costs (cost) and profit (profit), are achieved which then indicate whether the business model has operated properly in achieving business goals. The perspective of Islamic business has a different dimension from business in general which is value free. Islam has its own set of values, in which Islam regulates the entire way of individual life, from daily life to business activities.

Therefore, it becomes mandatory to regulate business activities based on the Qur'an. In Islam, the purpose of human life has been determined. Worldly life, including economic life, is only a means to achieve eternal life, the hereafter. There are several Islamic business models, such as the Islamic Enterprises of ElAshker (1987) business model adopted by Faisal Islamic Bank of Egypt. According to him, Islamic business goals must have two main pillars, namely business activities and social activities. The pillars of business activity are built from elements of the company's business functions that generate profits. Apart from that, it is also in the form of corporate social activities that are built from corporate zakat and infaq as well as company business units that have social goals. However, according to Oukil (2013), there is still a gap in business formulation in an Islamic perspective between the theoretical level and real business practice. This is due to differences in one's religious observances, and there are many misunderstandings due to mistakes in interpreting various business concepts. The real business practices of Muslim entrepreneurs are still not based on religious and ethical behavior. Institutionally, people are used to business activities that are not related to the afterlife. Most Muslims consider that their business practices should not conform to Islamic Sharia. Islamic business Islamic microfinance institutions are broadly defined as IMFI's way of providing services and managing its business to achieve its founding goals.

Based on the results of a case study conducted by the World Bank and Bank Indonesia in 2014, the differentiating factors for the Savings and Loan Cooperative (KSP) business model are business orientation, sources and uses of funds, investors and distribution targets, composition of funds, techniques for allocating funds, and membership. IMFI has different characteristics that make them have different business models. Some of them are: orientation or purpose as an Islamic institution and contract (aqad).

Sari (2010) states that performance measurement is generally categorized into non-financial and financial measurements. Non-financial performance is a measure of performance using non-financial information that is more focused in terms of service quality to customers. While the measurement of financial performance is the use of financial information in measuring the performance of a company. Commonly used financial information is the income statement and balance sheet.

3. METHOD

This study uses a qualitative approach with a case study analysis technique by Robert K. Yin. The subject is Islamic microfinance in East Java which was selected purposively with the manager and co-manager of Islamic cooperatives as key informants. This study uses triangulation of sources and techniques to ensure and test the accuracy of information.

Data collection was carried out in several stages. The first is through a Focus Group Discussion (FGD) with the managers of Sharia MFIs (10), representatives from the Office of Cooperatives (2), and a companion, namely Microfin (2). FGDs were conducted to look for various important elements in determining the sharia microfinance business model which was developed from elements of the credit union business model. In addition, the FGD also aims to obtain information about sharia cooperatives which have different business models from one another. After the elements of the business model were determined, data mining was carried out by interviewing managers of Islamic MFIs (5) which were indicated to have different business models.

The data analysis technique of this research uses content analysis method. The content analysis method is defined as a technique for drawing conclusions by identifying the special features of a message in an objective, systematic, and generalist manner (Holsti, 1969). This method is intended to analyze the overall discussion of various Islamic cooperative business models based on the elements that determine the business model.

4. RESULT AND DISCUSSION

A business model is a concept of how a business organization creates a certain value. This value can be in the form of economic value, social value or other forms of value and this value must be applied in all business activities. A business model can also describe how an organization manages its business operations to generate revenue. Due to the wide variety of business fields and each organization has its own way of generating revenue, the business model is also different for each organization. In addition, according to Siggilekow (2002), there is no consensus on a universally accepted definition of a business model. There are different views regarding the definition and also its elements. This condition indicates the existence of possibilities and opportunities to evaluate business models by way of adaptation, revision and reformulation. Morris, Schindehutte, & Allen (2005) stated that it is important to maintain the opportunity to continue research on business model elements. According to Morris et al (2005), most business models have various elements.

However, there are some elements that are similar across business models. Namely: 1) the value created/offered, 2) the economic model; 3) relationship with customers; 4) network; 5) internal infrastructure and 6) target market. As a specialized financial intermediary institution, Islamic cooperatives clearly have their own business model. From the Focus Group Discussion with stakeholders in Islamic Microfinance Institutions, the elements of the business model in Islamic Microfinance Institutions will differentiate one from another. These elements are also consistent with the elements of the Savings and Loan Cooperative (KSP) business model developed by the World Bank (2004). The elements of the business model in Islamic cooperatives are: establishment orientation, business and social functions, sources of capital and allocation, investors and customers, use of financing, types of contracts, allocation techniques, and cooperative membership.

4.1 Establishment Orientation

The development of Islamic Microfinance Institutions in Indonesia began with the emergence of *baitul maal wa tamwil* (BMT) in 1990 in the form of Community Self-Help Groups (KSM). The emergence of BMT was driven by Islamic economic activities which realized that achieving community welfare could be carried out with the dual roles of BMT simultaneously. On the one hand, BMT is a social institution that plays a role in alleviating poverty in Indonesia, especially the Muslim community by providing financing facilities, managing zakat, infaq and alms. On the other hand, BMT is a business unit owned by Muslim communities and aims to achieve shared prosperity and eradicate poverty (LPEI, 2012). The rapid development of BMT at that time did not have a legal basis so that the government responded by directing BMT to choose a cooperative as its legal entity.

The Minister of Cooperatives and Small and Medium Enterprises (UKM) issued Ministerial Decree No. 91 of 2004 concerning Sharia Cooperative Operational Permits, or legally called Islamic Financial Services Cooperatives (KJKS). This decision is supported by the Minister of Cooperatives and UKM Regulation No. 16 of 2015 with the official name KSPPS. Over time, Islamic Microfinance Institutions

known as Islamic Cooperatives have various orientations. There are IMFIs that were founded with a background of empowerment, but many are purely business-oriented. One of them is IMFI which was founded by Muhammadiyah, an Islamic organization called Baitu Tamwil Muhammadiyah (BTM). Baitu Tamwil means a business house with a purely business orientation.

4.2 Business and Social Functions

Although cooperatives are in the legal form, MFIs use the *baitul maal wa tamwil* concept. *Baitul maal* means a house of wealth which at the time of the Prophet and Caliph was a social institution. In this context, IMFI carries out social functions such as receiving and managing social funds such as *zakat*, *infaq*, *sadaqa*, *waqf* and *qardh hasan*. On the other hand, the *baitu tamwil* trading house is the second concept that is maintained by Islamic microfinance and this concept shows its business function. Islamic microfinance acts as a financial intermediary institution that connects surplus units with deficit units.

4.3 Sources and Allocation of Capital

Capital is an important concept for Islamic microfinance. As a closed financial institution, IMFI's main source of funding is savings. In a cooperative, the owner is a member of the cooperative who is required to deposit capital in the form of principal and mandatory savings. However, with the growing capacity of services and financing and limited savings, most IMFI are looking for sources of capital other than savings. Capital can be obtained from linkages with Islamic banks or other institutions. All capital will be allocated or used by Islamic cooperatives. As a financial intermediary, IMFI, known as the Sharia Cooperative, accepts deposits and will allocate them to members who need financing with a sharia-compliant contract (*aqd*). Some of the contracts that are mostly carried out by sharia cooperatives in their financing are *murabaha*, *ijarah Rompiiya bi tamlik*, and *mudharabah*. Not only financing, Islamic cooperative capital is also used for services for members and non-members. These services include payments, transfers and mortgage services.

4.4 Investors and Customers

As previously mentioned, deposits in Islamic cooperatives come from members' savings in the form of principal savings, mandatory savings and voluntary savings. In addition, IMFI (Islamic Cooperative) also accepts savings from non-member entities, both individuals and legal entities such as schools, mosques, foundations, etc. Apart from savings, IMFI obtains its capital from the linkage. The main linkage for IMFI is Islamic banks. Most of the IMFI with a large number of assets linkage with Islamic banks with an execution and channeling system. Not only with Islamic banks, capital is also carried out by Islamic cooperatives with other Islamic cooperatives, individuals, non-bank financial institutions, *zakat* institutions and government institutions. While IMFI in financing and other services has a diverse focus. Some IMFIs focus on services for members due to the property of their closed financial institutions. However, large capacity allows some IMFI to provide services to non-member entities in financing or other services.

4.5 Type of Financing

The main objective of sharia cooperatives is to provide access to financing services for Small and Medium Enterprises (SMEs) in order to increase their business financing. This financing scheme includes productive financing such as working capital and investment financing. However, many IFIs provide consumptive financing for members and the public, such as electronic goods, motorcycles, home renovations, etc. It can be concluded that most of the financing in IIFS can be classified into two groups, namely productive financing and consumptive financing.

4.6 Contract

As an Islamic financial institution, IMFI uses Islamic contracts. They can be classified into two categories, namely natural certainty contracts and natural uncertainty contracts. Natural certainty contracts are *murabahah*, greetings, *istishna*, *ijarah*, and *andijarah Rompiiya bi tamlik*. In this contract, IMFI can determine costs (both margin and *ujrah*) with a fixed amount before the contract is agreed. While the natural uncertainty contract is *mudharabah* and *musyarakah*. In this contract, IMFI only determines the proportion of lost profit sharing between sharia cooperatives and customers. The revenue that IMFI receives depends on the income or profit of the customer.

4.7 Allocation Technique

In contrast to banks which have limited financing requirements such as collateral, IMFI, known as Islamic cooperatives, often provide financing to individuals or small businesses without collateral. This condition causes many sharia cooperatives to use group financing with all members mutually sharing (takaful). In Indonesia, this system is called joint responsibility, in which all group members are responsible for the financing provided by the cooperative.

4.8 Membership

This composition is related to IMFI investors and customers (Sharia Cooperative). In fact, some Islamic cooperatives provide services such as savings, financing, and other services only for members. Other cooperatives only provide services to non-members because of the small number of members. There are also several cooperatives that provide services to member and non-member entities. Cooperative Law No. 25 of 1992 states that the cooperative principle is "from, by and for members". However, due to the large capacity of cooperatives, they provide dominant services to non-member entities. From the explanation above, a business model for sharia cooperatives in Indonesia can be designed as shown in Figure 1 below

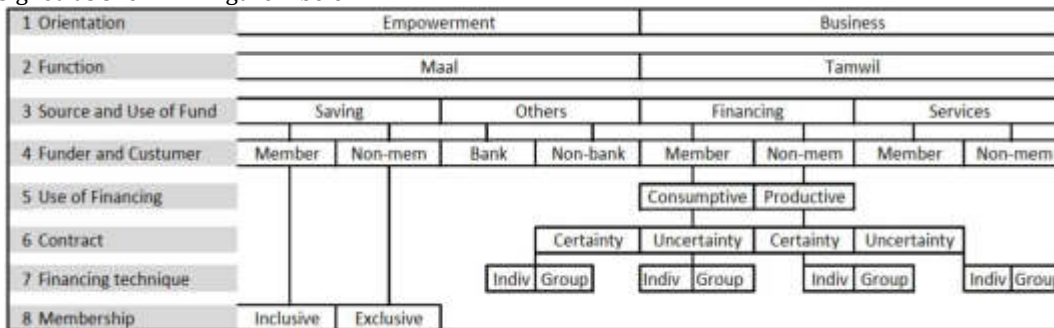


Figure 1. Business Model of Islamic Microfinance Institutions in Indonesia

From the IMFI's general business, it will be easier to define a particular IMFI's business model. An example is the Mandiri Sejahtera Syariah Cooperative in Gresik. The business model is shown in Figure 2 below.

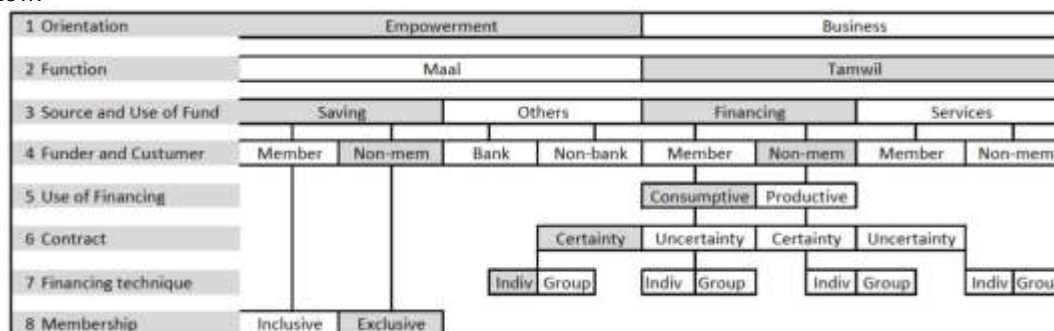


Figure 2. IMFI Mandiri Sejahtera Business Model

Figure 2 shows that IMF Mandiri Sejahtera has an empowerment orientation. The dominant source of funds is the savings of non-member entities. Capital allocation is dominated by financing products but mostly for non-members. Financing products are mostly for productive purposes, especially working capital because Mandiri Sejahtera customers are traders in markets located near the Mandiri Sejahtera offices. Although dominated by productive financing, financing contracts at Mandiri Sejahtera are dominated by natural certainty contracts, namely murabahah. Financing at Mandiri Sejahtera does not apply a joint responsibility model (individual), and exclusive membership. Its members are only 36 people even though it has large assets worth IDR 70 billion.

Another model is the Ki Slamet Islamic Cooperative in Lamongan as shown below.

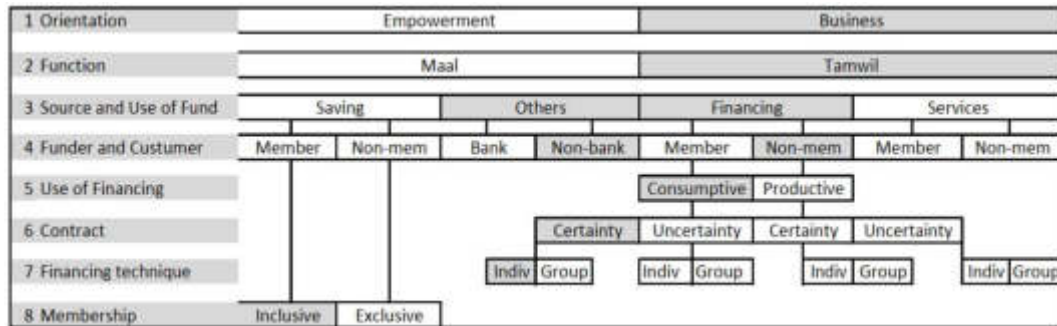


Figure 3. IMFI Ki Slamet's Business Model

This cooperative is business oriented and has a dominant business function. The main source of capital is a non-savings source, namely personal savings. There were IDR 2.7 billion of IDR 3.12 billion in assets in 2015 that came from personal savings and they got monthly profit sharing. With a small number of members, more funding from Ki Slamet is allocated to non-member individuals. The dominant contract is murabaha and adopts an open membership scheme.

5. CONCLUSION

As a business that was born from a Muslim community, Islamic Microfinance Institutions (MFIs) in Indonesia, known as sharia cooperatives, have diversity and unique characteristics. This condition makes the business model different at each IMFI. This is shown by the eight elements of the business model in IMFI, namely establishment orientation, business and social functions, sources of capital and allocation, investors and customers, use of financing, types of contracts, allocation techniques, and cooperative membership. These elements will form the IMFI business model that determines how IMFI carries out its business activities to achieve organizational goals.

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