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Business Model of Islamic Microfinance Institution: Indonesia Case

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ABSTRACT

Objective – Islamic Microfinance Institutions (IMFIs) grown very rapidly in the last 10 years in Indonesia. On 2015, the number of IMFIs' reached more than 5,000. As a business and social entity, IMFIs has various business models, the way in providing services and manages the business to achieve its goals. This study aims to determine the business models of IMFIs.
Methodology/Technique – This study uses qualitative approach by case study technique of Robert K. Yin. Subjects of this study are IMFIs in Indonesia that selected purposively with managers as a key informant.
Findings – The result is the business model of IMFI is determined by eight elements, namely: organizational orientation, business and social functions, the source of capital and allocation, investors and customers, financing usage, types of contract, allocation technique, and membership.
Novelty – The elements that determine IMFI, will form a business model of IMFI which determine how IMFI runs its business activities to achieve organization objective.
Type of Paper: Review

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JEL Classification: G21, L22.

1. Introduction

Since established on 1990, Islamic Microfinance Institution (IMFI) has grown rapidly. Thousands of IMFIs operated in many rural areas and cities in Indonesia. The phenomenon was responded by the government by issuing a decree of the Minister of Cooperatives and SMEs No. 91 of 2004 concerning an operational permit for setting up Islamic Financial Service Cooperative (Koperasi Jasa Keuangan Syariah/KJKS). Since then, thousands of Islamic cooperatives emerged in Indonesia. Regulation of the Minister of Cooperatives and Small and Medium Enterprises No. 16 of 2015 provides a reaffirmation of Islamic cooperative with the name of Koperasi Simpan Pinjam dan Pembiayaan Syariah (KSPPS).

As a business and social institution, IMFI has a business model that vary in achieving its goals. The business model is the logic of the overall business which is applied to its relation with the customer, chain of values, resources, operational management, income or profit generation, and the sustainability of the business entity. According to Osterwalder and Pigneur (2010), the business model can be defined as the

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conception of a set of elements which possible an enterprise to apply its business logic in a one company architecture with its network. This architecture comprises of production, marketing, and certain appreciation to the customer so it will result in a sustainable flow of income (Hendratmi, 2016).

Thus, the business model illustrates the concept of how a business organization can create value, both economic value, social and other forms of values and realize them in the overall business. Some important things that distinguish an entity's business model are the underlying value system and the design of the business in achieving its objectives.As a financial institution that has a business and social functions, Islamic cooperative has its own business model. In terms of value, the Islamic cooperative is inseparable from the values of Islam in all of its operations. In terms of interest, Islamic cooperative can focus on the business, focus on its social function, and in between. So also from the capital side, many Islamic cooperatives rely on capital from members, but most rely on outside capital. The focus of financing also vary. Most Islamic cooperatives focus only to members, but others focus on external parties or the public.The financial aim, capital, and targets are a few from among the indicators that will determine the Islamic cooperative business model. This study attempts to explore these indicators and analyze the business models of Islamic cooperative in Indonesia.

2. Literature Review

2.1. Islamic Finance

Islam requires every Muslim to thoroughly embrace Islam (Qur’an 2: 208), including in his/her economic and businesses activities. One rule in Islamic economics and business practices is the prohibition of riba (Qur’an 2: 275). The scholars' claim that the interest (usury) imposed by financial institutions, such as banks, insurance companies, cooperatives, and so forth is considered as Riba in Islam. Scholars of fiqh equate (qiyas) interest with riba because interest has characteristics similar to riba (Antonio, 2001).

Prohibition of interest gave a consequence of the substitution model of modern financial intermediation that is not based on interest. Chapra (2001) calls the substitution is the using of its own capital (equity) and a bit of credit consisting of a combination of primary and secondary modes. The primary mode in replacement of interest in this financial intermediation is a revenue sharing system, ie mudarabah (passive partnership) and musharaka (active partnership). Meanwhile, the secondary mode in the form of buying and selling (murabaha, salam, istishna) and rent.

According to Chapra (2001), the sharing system through mudarabah and musharakah should be the main character of Islamic financial institutions. Because sharing system provides profit and loss fairly. Should the profit is high then the capital owner dan the manager would get high profit.This scheme should be applied as well for the loss (Ryandono, 2009). In addition, the sharing system is more comply to the Shariah compared to murabahah and ijarah.

Thus, the Islamic cooperative must comply with the sharia rulings, be it for the institution, its management, and contracts used. As Islamic financial intermediary institutions, Islamic cooperatives are required to practice the contract in accordance with the sharia in intermediation activities, namely funding and the financing of the funds. Compliance with the sharia is not only in terms of fiqh, in which contracts used are not only in accordance with the provisions of sharia but also in substance that is the objective of shariah enactment.

According to Islamic jurisprudents (fuqaha), the ultimate goal of all rules or the implementation of sharia is the achievement of maqasid sharia, where the point is maslahah. Al-Qaradawi (2006) says that the purposes of the Shari'a are the wisdom on the implementation of the Sharia law. It is explained that the wisdom of each rule is a mercy to mankind (Qur'an 21: 107). Prophet Muhammad was sent on purpose: "there is no intention We sent thee (Muhammad), but a blessing for the whole of nature". Mercy for the whole of nature in the hadith interpreted as a benefit of the people. The scholars agree that it is indeed Islamic Shari'ah containing benefit.

Thus, the entire Islamic financial institutions are not allowed to use interest as an instrument in providing compensation to depositors and charged to borrowers. Besides interest, the Islamic financial institutions should also avoid maysir, gharar, unclean products and mechanisms, and injustice (Mawardi, 2015).

2.2. Islamic Microfinance Institution (IMFI)

One of the Islamic financial institutions practicing financial intermediation in Indonesia is Islamic Microfinance Institution (IMFI). Pursuant to Rule Minister of Cooperatives and SMEs No. 16 in 2015, the IMFIis a cooperative that runs savings and loan and financing with Islamic pattern which is called Credit Unions and Islamic Financing (KSPPS). Pursuant to Rule Minister of Cooperatives and SMEs, KSPPS has a business and social activities include deposits, loans and financing according to Islamic principles, managing zakat, infaq/alms, and endowments.

Islamic principles intended are the principles of Islamic law in the activities of cooperative efforts based on the fatwa issued by the National Sharia Board of the Indonesian Ulema Council (DSN-MUI). Thus, the entire operations of cooperatives should be in accordance with the sharia fatwas from National Sharia Council or so-called MUI.

As cooperative, IMFI is a closed intermediary institution, ie receiving deposits and disbursing financing with Islamic Shariah compliance covenants only to members of the cooperative. Additionally, as a business organization that is also social institutions, IMFIcan receive and distribute zakat, sadaqah and infaq, as well as manage the waqf property. IMFIin Indonesia adopted the concept of the Baitul Maal wa tamwil, which as a business institution (baitul tamwil) and social institutions (Baitul Maal) (Hamdan, 2014).

According to Hamdan (2014), as business organizations, Islamic microfinance runs financial intermediation function. IMF receive deposits in the form of savings, compulsory savings, voluntary savings, and savings equated with mandatory savings with sharia contract. Akad (contract) used is wadiah and mudaraba. IMFIs give loans to members using Shariah compliance contract, namely murabaha, salam, istishna, Ijara and Ijara muntahiya bi Tamlik. As a social institution, Islamic cooperative could be 'amil zakat, infaq, and Sadaqah. IMFIreceive and distribute to those entitled. In addition, the IMF can also be nadzir or managers of endowments (waqf).

According to the Ministry of Cooperatives and SMEs, the number of Islamic cooperatives in Indonesia was 3,307 in 2010 with assets of Rp 3.6 trillion. In 2015, the number of Islamic cooperatives has increased to more than 5,000 with assets of more than Rp 4.7 trillion. Most Islamic cooperative has many branches to provide services to members and the community in various villages and towns (Hasbi, 2015).

2.3. Business Model

One element of the business in the perspective of the real practice is a business model. The business model is the overall business logic applied in conjunction with the customer, who belongs to the value chain, resources, operational management, to design and sustainability of revenue or profit business entities. According to Osterwalder and Pigneur (2010), the business model is the conception of a set of elements that enable companies to be able to appreciate the business logic within one company architecture and its network. This architecture includes the production, marketing, as well as the provision of particular value to the customer resulting in valuable revenue streams and sustainable.

The business model illustrates the concept of how a business organization can create value, both economic value, social, or other forms of values, and realize the overall business. Based on the concept, business model requires an important instrument, namely the value system underlying business entities, and business design to achieve the goal.Currently, there is no consensus on the definition of a business model that agreed together. Likewise, there are various definitions and elements of the formation. Various business models have been developed. According to Hendratmi (2016), most of the business model has various constituent elements of that of the entire business models have common elements: 1) the value offered (create value), 2) the economic model; 3) relationships with customers; 4) network; 5) internal infrastructure and 6) the target market.

The most significant on the business model is the relationship between revenue and cost which resulted in profit. Emphasis on cost will determine the amount of profit and the advantage generated. Although the creation of the value becomes the main soul, two important pillars are the cost (cost) and profit (profit) reached which then indicates whether the business model has been operating well in achieving the business goals.

Islamic business perspective has different dimensions to the general business which is value-free. Islam has its own value set, where the Islamic rules the whole way of life of individuals, ranging from daily life to business activity. Therefore, it becomes obligatory to regulate business activity that is based on the Koran. In Islam, the purpose of human life has been determined. Worldly life, including economic life, is only a means to attain eternal life, the hereafter.

There are several Islamic business models, such as the business model of Islamic Entreprises of El-Ashker (1987), which was adopted by Faisal Islamic Bank of Egypt. According to him, the Islamic business objectives should have two main pillars, namely business activities and social activities. The Pillar of business activity is constructed from elements of corporate business functions that generate profits. In addition, also in the form of corporate social activities which are built from company’s zakat and donation as well as company’s business units with social goals. However, according to Oukil (2013), there remains a gap in the formulation of business in the Islamic perspective between the level of theory to real business practices. It is because of the difference in one’s religious observance, and there are a lot of misunderstandings because of errors in interpreting various business concepts.

The real business practice of Muslim entrepreneurs is still not based on religious and ethical behavior. Institutionally, the public has been accustomed to business activities which are not related to the hereafter. Most Muslims consider that its business practices should not be adjusted with the Islamic Shariah.Islamic business of Islamic microfinance institution is broadly defined as the way of an IMFIin providing services and manages its businesses to achieve its founding purpose. Based on the results of a case study conducted by the World Bank and Bank Indonesia in 2014, the differentiating factor the business model between Credit Unions (KSP) is business orientation, source and use of funds, financiers and targeted distribution, fund composition, techniques for fund allocation, and membership. IMFIs have different characteristics that make them have a different business model. Some of them are: orientation or goals as an Islamic institution and contract (aqad).

3. Methodology

This study used the qualitative approach with case study analysis techniques of Robert K. Yin. The subjects are Islamic microfinance in East Java selected purposively with managers and co-manager of Islamic cooperatives as key informants. This study uses triangulation of sources and techniques to confirm and test the veracity of the information.

Data collection is done in several stages. The first is through a Focus Group Discussion (FGD) with managers of the Islamic microfinance institution (10), representatives from the Department of Cooperatives (2), and a companion which is Microfin (2). FGD is done to look for a variety of important elements in determining the Islamic microfinance business model that was developed from elements of the credit union business model. In addition, the FGD is also aimed at obtaining information on Islamic cooperatives that has a business model which are different to one another. Once the elements of the business model are set, then the data mining done by interviewing managers of Islamic microfinance institution (5) indicated to have different business models.

The data analysis technique of this research using content analysis method. The content analysis method is defined as a technique to draw conclusions by identifying specific characteristics of a message in an objective, systematic, and generalist (Holsti, 1969). This method is intended to analyze the whole discussion about the Islamic cooperative business model which is vary based on the elements that determine the business model.

4. Results and Discussions

The business model is a concept on how a business organization creates certain value. The value may in form of economic value, social value or other forms of values and this value must be implemented in entire business activities. The business model can also describe how an organization manages its business operations to generate income. Due to various fields of business and each organization has its own way to generate income, business models are also different in each organization. Moreover, according to Sigglekow (2002), there is no consensus yet about the definition of a business model that universally accepted. There are different views regarding its definition and also its elements. This condition shows there is a possibility and opportunity to evaluate a business model by adaptation, revision, and reformulation. Morris, Schindehutte, & Allen (2005) stated that opportunity to continue research about elements of a business model is important to be maintained.

According to Morris et al (2005), most business models have various elements. However, there are some elements that similar in all business models. They are: 1) created/offered value, 2) economic model; 3) relation with customers; 4) network; 5) internal infrastructure and 6) target market. As a special financial intermediary institution, Islamic cooperative obviously has its own business model. From Focus Group Discussion with stakeholders in Islamic Microfinance Institution, elements of the business model in these Islamic Microfinance Institutions will differentiate one and others. These elements are also in accordance with business model elements of Saving and Lending Cooperative (Koperasi Simpan Pinjam/KSP) that developed by World Bank (2004).

Elements of business model in Islamic cooperatives are: establishment orientation, business and social functions, source of capital and allocation, investors and customers, financing usage, types of contract, allocation technique, and cooperative’s membership

a. Establishment Orientation

Development of Islamic microfinance Institution in Indonesia started with the emergence of baitul maal wa tamwil (BMT) in 1990 in form of self-help group (Kelompok Swadaya Masyarakat/KSM). The emergence of BMT was driven by Islamic economics activities who realized that achieving welfare of society can be implemented by double roles of BMT simultaneously. On one side, BMT is a social institution that has a role in poverty alleviation in Indonesia, especially on Moslem society by providing financing facility, managing zakah, infaq and sadaqa. On the other side, BMT is a business unit, owned by Moslem society and has objective to achieve common welfare and eradicate poverty (LPEI, 2012).

The rapid development of BMT had no legal basis at the time so government responded by directing BMT to choose cooperative as their legal entity. Ministry of Cooperative and Small and Middle Enterprises (SMEs) enacted Minister Decree No. 91 the year 2004 about operational license for Islamic cooperative, or legally written as Islamic Financial Service Cooperative (Koperasi Jasa Keuangan Syariah/KJKS). The decree is supported by Regulation of Minister of Cooperative and SMEs No.16 year 2015 with official name is Cooperative of Saving, Lending and Islamic Financing (Koperasi Simpan Pinjam dan Pembiayaan Syariah/KSPPS).

As time passed, Islamic microfinance Institutions as known by Islamic Cooperative have various orientations. There are IMFIsthat established with empowerment background, but many of them are purely business oriented. One of them is IMFIsthat established by Muhammadiyah, an Islamic organization and its name are Baitu Tamwil Muhammadiyah (BTM). Baitu tamwilmeans house of business which consists of purely business orientation.

b. Business and Social Functions

Although cooperative is its legal form, Islamic microfinance Institutionusesbaitul maal wa tamwilconcept. Baitul maalmeans house of wealth which in Holy Prophet and Caliphs era was a social institution. In this context, IMFI runs social function such as receive and manage social funds such as zakah, infaq, sadaqa, waqf and qardh hasan. On the other hand, baitu tamwilor commercial house is the second concept maintained by Islamic microfinance and this concept shows its business function. Islamic microfinance acts as financial intermediary institution that connects surplus unit with deficit unit.

c. Capital Source and Allocation

Capital is an important concept for Islamic microfinance. As a closed financial institution, the main source of fund for IMFI is saving. In a cooperative, owners are members of cooperative who obliged to deposit capital in form of principal and obligatory saving. However, as service and financing capacity grow and limitation of its saving, most IMFIs seek capital sources other than saving. Capital can be obtained from linkage with Islamic banks or other institutions. All capital will be allocated or utilized by Islamic cooperative.

As a financial intermediary institution, IMFI which known as Islamic Cooperative receives saving and it will be allocated to members who need financing with sharia comply contracts (aqd). Some contracts that mostly conducted by Islamic cooperative in its financing are murabahah, ijarah muntahiya bi tamlik, dan mudharabah. Not only financing, Islamic cooperative’s capital is also used for services for members and non-members. These services include payment service, transfer and mortgage.

d. Investor and Customer

As mentioned earlier, savings in Islamic cooperative comes from members’ savings in form of principal, obligatory saving, and voluntary saving. Besides, IMFIs (Islamic Cooperative) also receives savings from non-member entities, either individuals or legal bodies such as schools, mosques, foundations, etc.Outside savings, IMFI obtains its capital from the linkage. The main linkage for IMFI is Islamic banks. The most IMFIswith large amount of assets make linkage with Islamic banks with executing and channeling systems. Not only with Islamic banks, the capital linkage is also maintained by Islamic cooperative with other Islamic cooperatives, individuals, non-bank financial institutions, zakah institutions and government agencies. Meanwhile, IMFI in its financing and other services has various focuses. Some IMFIs focus on services for members due to their enclosed financial institution property. However, large capacity enables some IMFIs to provide services for non-member entities in their financing or other services.

e. Type of Financing

The main objective of Islamic cooperative is providing access to finance services for Small and Medium Enterprises (SMEs) in order to enhance financing of their business. This financing scheme includes productive financing such as working capital and investment financing. However, many IMFIs provide consumptive financing for members and society such as electronic goods, motorcycle, house renovation etc. We can conclude that most financing in IMFIscan be classified into two groups, i.e. productive financing and consumptive financing.

f. Contract

As an Islamic financial institution, IMFI uses sharia-compliant contracts. They can be classified into two categories, i.e. natural certainty contracts and natural uncertainty contracts. Natural certainty contracts are murabahah, salam, istishna, ijarah, andijarah muntahiya bi tamlik. In these contracts, IMFI may determines cost (either margin or ujrah) with fix amount before the contract is agreed upon.Meanwhile, natural uncertainty contracts are mudharabah and musyarakah. In these contracts, IMFI only determines profit-lost sharing proportion between Islamic cooperative and customer. Revenue that received by IMFI depends on revenue or profit of customer.

g. Allocation Technique

Different with a bank that has restricted requirements in their financing such as collateral, IMFI which known asIslamic cooperative often provides financing to individuals or small business without any collateral. This condition causes many Islamic cooperatives use group financing with all members bear for each other (takaful). In Indonesia, this system is called tanggung renteng, which all members of the group responsible for financing that given by cooperative.

h. Membership

This composition is related to investors and customers of IMFI (Islamic cooperative). In reality, some Islamic cooperatives provide services such as saving, financing, and other services to members only. Other cooperatives just provide services to non-members due to small number of members. There are also some cooperatives provide services for both members and non-member entities.

Cooperative Act No. 25 the year 1992 stated that principle of cooperative is “from, by and for members”. However, due to the large capacity of cooperatives, they provide dominant services to non-member entities. From above explanations, a business model for Islamic cooperatives in Indonesia can be designed as shown in Figure 1 below.

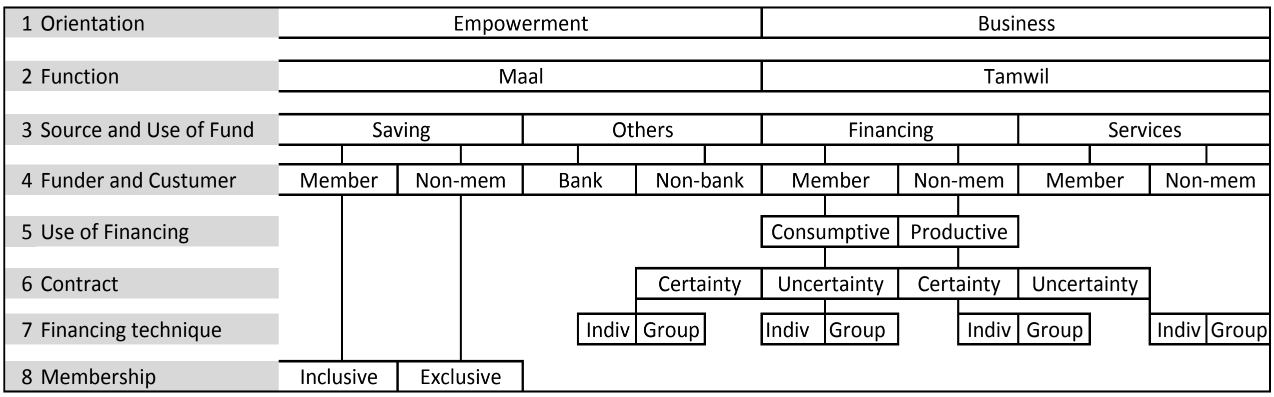

Figure 1. Business Model of Islamic Microfinance Institutionin Indonesia

From general business of IMFI, it will be easier to determne business model of certain IMFI. As an example is Islamic Cooperative Mandiri Sejahtera in Gresik. Its business model is shown in Figure 2 below.

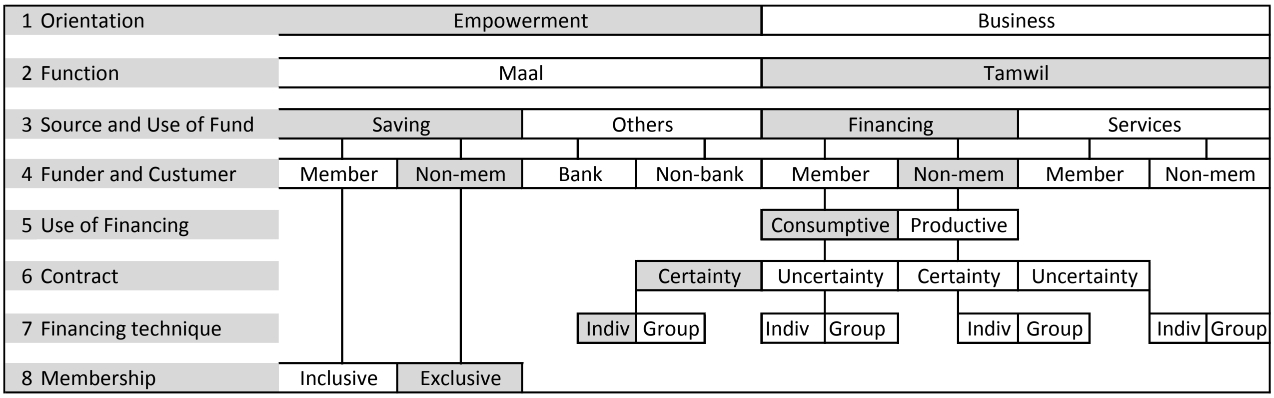

Figure 2. Business Model of IMFIMandiri Sejahtera

Figure 2 shows that IMF Mandiri Sejahtera has empowerment orientation. The dominant source of fund is non-member entities' saving. Capital allocation is dominated by financing products but mostly for non-member. Financing products are mostly for productive purposes, especially working capital because Mandiri Sejahtera's customers are traders in the market who located near Mandiri Sejahtera's office. Although dominated by productive financing, financing's contract in Mandiri Sejahtera is dominated by natural certainty contract i.e. murabahah. Financing in Mandiri Sejahtera does not implement tanggung renteng model (individual), and exclusive membership. It has only 36 members despite having large assets that valued Rp 70 billion.

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

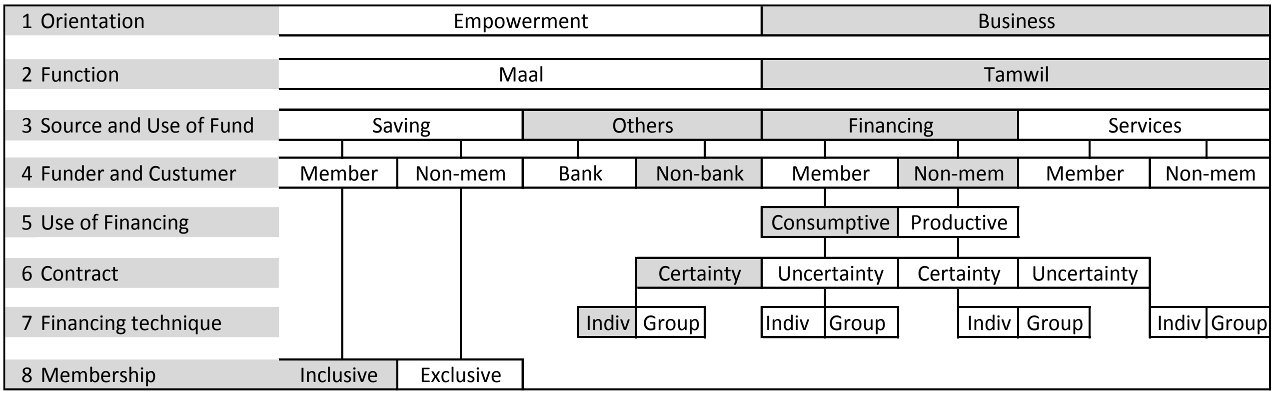

Figure 3. Business Model of IMFIKi Slamet

This cooperative is business oriented and business function is dominant. The main capital source is non-saving sources, i.e. personal fund deposit. There is Rp 2.7 billion out of Rp 3.12 billion asset in 2015 that comes from personal fund deposits and they get monthly profit sharing. With fewer members, financing from Ki Slamet mostly allocated to non-member individuals. Dominant contract is murabahah and it adopts open membership shceme.

5. Conclusion

As the business that emerged from Moslem society, Islamic microfinance institution (IMFI) in Indonesia which known asIslamic cooperatives have diversity and unique characteristics. This condition makes business models vary in each IMFI. It is shown by eight elements of the business model in IMFI especially establishment orientation, business and social functions, the source of capital and allocation, investors and customers, financing usage, types of contract, allocation technique, and cooperative's membership. Those elements will form business model of IMFI which determine how IMFI runs its business activities to achieve organization objective.

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