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MAQASHID SHARI'AH ON ISLAMIC MICROFINANCE AND THE ISSUES AND CHALLENGES IN PROMOTING ISLAMIC MICROFINANCE IN INDONESIA: A SCHOLAR'S PERSPECTIVE

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ABSTRACT

Shari'ah-based economy framework with attributing social objective is a broad term of *Shari'ah*-based finance. Focusing on equal distribution in economic growth indicates realizing of *maqasid Shari'ah* which is posed by Islamic economic objectives. Islamic microfinance emerges based on Islamic financial principles in providing financial services to the poor. Beside free interest-based, promoting economic justice based on the ethical responsibility is another characteristic of Islamic microfinancing. With such characteristics, Islamic microfinance institutions (MFIs) should easily achieve *maqashid Shari'ah*. This study attempts to analyze Islamic microfinance practitioners and scholars' views on what to extent the role of Islamic MFIs in achieving *maqashid Shariah*. The study also examines the issues and challenges emerge in promoting Islamic MFIs in Indonesia. Qualitative approach with semi-structures interview used in the study. Seven respondents consisting of practitioner and academician are interviewed based on their expertise. Results of this study indicates Islamic microfinance institutions (MFIs), in this case *Baitul Maal wa Taamwil* (BMTs) are not really in line with *maqasid Shari'ah.* This is due to the most of the current practices of BMTs provide *murabahah* as the dominant financing, indicating impose the clients with margins higher. This does not reflect justice or equal distribution income for the customer. The study also documents that human capital, regulation issue, the role of the government and lack of capital issues are the most important issues and challenges raised in promoting BMTs in Indonesia. The study suggests that to minimise overlapping financial cooperative rules, the needs for collaboration among government institutions such as Ministry of Cooperative and OJK to synergise cooperative law regarding BMT and microfinance.

Keywords: *Islamic microfinance, Baitul Maal wa Taamwil, maqashid Shari'ah, qualitative and Indonesia*

Introduction

The purpose of Islamic law (*maqashid Shari'ah*) is to promote welfare (*maslahah*) of mankind and prevent harm (*mafsadah*). Ibn Ashur stated that objectives of the *Shari'ah* should include the preservation of order, promotion of human welfare, prevention of corruption, establishment of justice and, maintaining stability and harmony (al-Raysuni, 1992). Al-Ghazali emphasized on five objectives of the *Shari'ah*: faith (*din*), the human self (*nafs*), intellect (*'aql*), posterity (*nasl*) and wealth (*mal*) (Chapra, 2007). Meanwhile, Abu Zaharah (1997) classified specific objective of *Shari'ah* into three broad areas, namely educating individual (*Tahdhib al-Fard),* establishing justice (*Iqamah al-`Adl*) and promoting Welfare (*Jalb al-Maslahah*) (Mohammed et al., 2008).

The principle objective of Islamic economics is to understand the *maqasid Shari'ah* which supposed to show in the economy as empowering development and equity (Siddiqi, 2004). This indicates more than achieving the legal forms, promoting social needs of a society also should be achieved by Islamic financial system.

Some studies believed that Islamic microfinance institutions (MFIs) may have potentially fulfilling the *maqasid Shari'ah* with respect to public interest (*maslahah*). Ahmed (2002) argues that Islamic MFIs have an advantage over Islamic bank since it can use Islamic charitable funds such as *zakat, infaq, sadaqah* and *waqf* as its sources of fund to finance productive activity of the poor. Abdul Rahim (2007) also asserts that main objectives of microfinance schemes to alleviate poverty and enable the poor to empower themselves are in line with the Islamic economic principles of justice. In empirical study, Alam et al. (2015) revealed that the microcredit program of AIM has an enhancing effect on the livelihood of clients that is reflected in the assessment of their well-being in the context of *Maqasid Al-Shariah*.

However, the study revealed that Islamic MFIs lack of product diversification, offering only one or two Islamic financing products and over 70 percent of the products offered are *murabahah* (Md. Saad, 2012). Ahmed (2002) mentioned that in current practice of Islamic MFIs have attempted to follow pure *murabahah* but with the expansion of their operations, Islamic MFIs have gradually neglected the practice. *Murabahah* financing is also applied in Indonesia's BMT as studied by Nurkholis (2010) and in Yemen's Hodeidah as studied by Al-Zam-Zami and Grace (2002). With regard to the issues, to what extent can Islamic MFIs achieve

maqasid Shari'ah? This study attempts to analyse to what extent Islamic MFIs in Indonesia can achieve *maqasid Shari'ah*. The study also examines the challenges and issues raised in Islamic MFIs.

Islamic MFIs in Indonesia

Islamic MFIs in Indonesia began in 1984 when the student of Institut Teknologi Bandung (ITB) founded an institution incorporating the concept of *Baitul Maal* (House of Treasury) and *Baitul Tamwil* (House of wealth development), popularly called BMT or *Baitul Maal wat Tamwil*. For Baitul Maal, BMT collects Islamic charity fund such as *zakat, infaq* and *sadaqah* from communities and used to assist the poor to fulfil their daily needs while for *Baitul Tamwil*, it accumulates savings from the communities. The savings are channelled in the form of financing and equity-based to low-income people especially to the active poor.

In 1991, *Bank Perkreditan Rakyat Syariah* (BPRS or Islamic Rural Bank) were established after a meeting of *Majelis Ulama Indonesia* (MUI) or the Indonesian National Council of Islamic Scholars that declared the prohibition of interest (*Riba*). While the declaration supported the establishment of Islamic Rural Bank based on *Shari'ah* principles, the bank is regulated by National Act No.7/1992, amended by National Act No.10/1998. Thus, like other banks, BPRS are supervised by the Central Bank of Indonesia.

Islamic MFIs in Indonesia are divided into BMTs, BPRs and Islamic micro-banking. In terms of clients, they have different target groups despite these three institutions providing a small amount of financing. For BMTs, they usually serve the lowest income group as most of their clients are micro-entrepreneurs or petty traders in traditional markets and sometimes farmers. While BPRS serve the lower income group, those who have more stable or established business might be classified as small entrepreneurs rather than micro-entrepreneurs. For Islamic micro-banking, they offer services to lower-upper and middle-income groups, and some of their clients come from similar income group as the clients of BPRS. Despite having a similar type of clients, Islamic bank can offer the better Islamic microfinance services compared to BPRS. This is because Islamic micro-banking is supported by large capital of Islamic bank so that the financing given is higher than given by BPRS.

In respect to this, Obaidullah and Khan (2008) classified the Indonesian clients into clients who have experience with existing operational business

at least two years, and new clients who have no business experience. Some Islamic financial products such as *murabahah, musharakah* and *mudarabah,* which deal with margin and profit-loss-sharing, are more suitable financing for those who have a good track record and business experience. While *qard al-hasan* financing is most appropriate for new clients that have no or less good track record and considered very risky.

Islamic MFIs and Maqashid Shariah

Islamic scholars like Al-Ghazali and Al-Shatibi developed the principle of *Maqasid Shariah* and classified human needs into three broad categories, namely, the *daruriyyat (essentials)*, *hajjiyyat* (supporting), and *tahsiniyyat* (embellishments) *(*Alam et al., 2015). Specifically, Al-Ghazali emphasized on five objectives of the *Shari'ah*: faith (*din*), the human self (*nafs*), intellect (*'aql*), posterity (*nasl*) and wealth (*mal*) (Chapra, 2007). Abu Zaharah (1997) classified specific objective of *Shari'ah* into three broad areas, namely educating individual (*Tahdhib al-Fard),* establishing justice (*Iqamah al-`Adl*) and promoting Welfare (*Jalb al-Maslahah*) (Mohammed et al., 2008).

Previous study, such Alam et al. (2015), have examined role of Islamic microcredit programs based on the achievement of *Maqasid Shari'ah* emphasized by Imam Al-Ghazali. Their study found that the indicators of *Din*, *Nafs*, *Nasb* and *Maal* improved after participating in the microcredit program, however, the indicators of *Aql* were not significantly enhanced by this program. Moreover, numerous borrowers claimed that their involvement in the microcredit program did not help them gain additional knowledge or business skills. Ahmed (2011) assesess the implementation of the general objectives of *maqashid Shari'ah* at the level of products. *Maqashid Shari'ah* is set into two requirements, one legal and the other social requirements. The study revealed that there were three types of Islamic financial products identified. Firstly, a *Shariah*-based financial product which is fulfilling both the legal and social requirements. Secondly, a *Shariah* compliant product which us fulfilling the legal requirement but not social requirements. And thirdly, a pseudo-Islamic product is one that fulfills the form but not the substance of Islamic law. Mohammad and Shahwan (2013) found that the objectives of Islamic banks mostly aimed towards profit-oriented entity rather than social-based entity. The study suggested that Islamic banks' objectives should promote the objectives of Islamic economics thus inculcating as well *Maqasid Shari'ah* in its holistic direction.

Issues in Islamic MFIs

Several issues are raised in Islamic microfinance, namely the question of product authenticity, a limited number of *mudharabah* and *musharakah*, *Shari'ah* compliance, and lack of fund. According to Karim et al. (2008), the pricing of some *Shari'ah* compliant products offered was too close to the pricing of conventional products. For example, *murabaha* financing which interest appears to be vague as a cost markup or administration fee. Therefore, Karim et al. stated that Islamic finance sometimes suffers from the perception that it is simply a "rebranding" of conventional finance and not truly reflective of Islamic principles.

Another issue is the limited number of *mudharabah* and *musharakah* financing. As known, *murahabah* financing is a very popular product among Islamic MFIs, and they rely heavily on this type of financing. This is because the process of *murahaba* financing is easy and low risk which is just simply Islamic MFIs buy requested goods and sell back it to the clients with a deferred payment. However, poor people have various financial needs, and many of them require some products such as savings, micro-insurance, transfer service or even housing products. The innovative design of a range of *Shari'ah* compliant products and services would provide greater financial access to a broader segment of Islamic microfinance customers. (Karim et al., 2008).

Moreover, among the most issues faced by the Islamic financial industry is the lack of expertise both in *Shari'ah* and financial management. As Saeed et al. (2009) found that the practice of Islamic financing in Bangladesh particularly *mudharabah* financing is not similar to what has been theoretically known. However, the *mudharabah* has become similar to *murabahah* as the Islamic MFIs bought goods requested by clients and considered them as an investment in the partnership. The clients, thus, repay the financing periodically.

Another *Shari'ah* compliant issue is misuse in the use of *murabahah* financing. As a survey conducted by Ahmed (2002) revealed that the use of *bay-muajjal* financing opens an opportunity to abuse financing by way of diluting instead providing the goods/assets. This is because operating modes of this financing is costly and at times impossible to buy the goods/assets that beneficiaries want (Ahmed, 2002). Lastly, lack of fund is one of the issues that may hamper the expansion of MFIs. It might be due to nature the institution which cannot offer deposits the same as conventional bank

practice (Ahmed, 2002). There is a need for great funds when MFIs are in the initial stages of operation while the beneficiaries' savings is still small.

Methodology

Qualitative approach with judgement sampling which a non-probability is sampling technique used in this study. An interview used to generate information in respect of qualitative data from the respondents. The interview covers the two objectives and involves seven scholars in microfinance including practitioners and academicians. Semi-structured interview is employed in the study. The justification for adopting semi-structured is the technique allows the researcher to arrange questions based on the themes of study and focus on the questions to be discussed. Moreover, it also enables the researcher to design the inverview in a systematic manner and ask the interviewee to participate (Morse and Richards, 2002). The respondents will be asked questions with regard to what extent Islamic microfinance can achieve maqashid Shari'ah and issues raised in promoting Islamic MFIs.

Results

Qualitative data analysis used to achieve objective of the study that related to the scholars' views on the achieving Islamic MFIs on *maqashid Shari'ah* and the issues and challenges raised in promoting Islamic MFIs in Indonesia. Four academicians specialized in Islamic microfinance and three practitioners from BMT agreed to be the interviewees. Their profiles are listed under Table 1. Each interviewees quotation is numbered (R1-R7) for ease of reference to the respondents' profile.

Table 1 Profile of the Respondents

No.	Qualification	Specialization/Position	Working Experience
R1	Master	Ass. Manager	5 years in BMT
R2	Master	Manager	5 years in BMT
R3	Master	*Fiqh* and Islamic banking and finance	6 years research and consultation in Islamic banking and finance
R4	PhD	Islamic banking and Finance, waqf	10 years in teaching and research in

			Islamic banking and finance, Islamic economics
R5	PhD	Manager	8 years in BMT
R6	Master	Islamic banking and finance	15 years in teaching Islamic banking and finance and research
R7	PhD	Islamic finance, zakat, waqf, Islamic microfinance	10 years in teaching Islamic banking and finance, Islamic economics

Islamic MFIs and Maqasid Shari'ah

In different ways, most of the respondents viewed that contribution of Islamic MFIs, in this case BMTs for achieving *Maqasid Shariah* is relatively low. According to respondent two, the major level of low contribution to achieving the *Maqasid Shari'ah* is using the *Murabahah* mode as a dominant contract. He stated that:

> Theoretically, it is in line with Maqasid Shariah... because that BMT comes from and to members which this concept is more known as cooperative but practically, we incline to use Murabahah mode as most contracts… Furthermore, if sources of funds we get from linkage program of bank, we must use Murabahah contract (R2)

The third respondent focused on what normally causes a problem in using the *Murabahah* contract is that BMTs charges the clients with high margins. He mentioned that:

> Theoretically yes..., But practically, even public claim that the practice of BMT is worse than that of bank. Evidence showed that how they put on margin or a certain administration cost of contract (*akad*) is relatively higher than other counterpart institutional including conventional bank. Thus, if we talk about equal wealth distribution for me is far away from the ideal (R3).

In a view similar to the above provided by respondent six, BMT gains high profit margin.

> […] Sadly, if small trader is imposed higher rate than conventional bank charges... so that it is not in line with Maqasid Shariah (R6).

Besides having a high margin rate, BMT is not targeting the lowest income group instead of targeting the lower income group who have established business such as a petty trader, vendor street, etc. It is in view of that, respondent seven maintained that:

> […]. Thus, if we talk about *Maqashid Shari'ah*, BMT just touched lower income group that have a business but not touched yet the poorest of the poor although there is a Baitul Maal but this portion is still few. […] not surprisingly if growth of BMT's asset is faster because in terms of profit margin is very high (R7).

In addition to the above points, the fourth respondent was contrary to the previous views. According to his understanding, regardless of their shortcoming, most BMTs have already practised two or three elements of *Maqasid Shari'ah.* He mentioned some examples of those elements in his words:

> […] in terms of protection of *Maal* what I can say that BMT have already fulfilled this type of protection. […] with providing the financing, microenterprises have developed their business, so create more jobs and gain profit and so forth. […] Then in terms of *Deen*, BMT can organise a spiritual training and religious. In terms of intellect, BMT through its *Maal* may provide training program to their clients to improve their skills on how-to do-good business (R4)

With regard to the suitability of equal wealth distribution, BMT is more applicable since it targets a large number of micro-business. Respondent five asserted that:

> I think generally, BMT is a '*dakwah*' movement which concern on Islamic financial institutions…this achievement

> of *Maqashid Shari'ah* in the context of justice wealth distribution is more applicable than the bank system. […] BMT can be functioned as financial inclusion although it can be done by bank…but it can be more effective by using BMT because the procedure is very easy than bank (R5)

However, respondent one's statement indicated that BMT still gives low contribution for unequal wealth distribution which means low contribution to achieving the *Maqasid Shari'ah*.

> Not really, […] there is a problem. In contract, it is pretend away from *riba* but distribution barrier is still happened. […] they are still strong in using *Murabaha* mode and are still difficult to move it into *Mudharabah / Musharakah* product (R1)

Low contribution for *Maqashid Shari'ah* has been clearly addressed to BMT when it is associated to equitable distribution of income and wealth issue. The majority of the respondents indicated that since most of the current practices of BMTs provide *murabahah* as the dominant financing, it is relatively hard to be in line with the *Maqasid Shari'ah*. The reason is this Islamic mode of financing can impose the clients margins higher than conventional microfinance one. Lack of fund source makes BMTs seeking the funds from third-party institutions through linkage programs which sometimes requires BMTs to offer *Murabahah* financing to their clients. There is no alternative option for financing contracts oriented to risk sharing or partnership (*Mudharabah/Musyarakah*). The dominance of third-party funds from large financial institutions on Islamic microfinance products has made the social mission of BMTs to the public interest (*Maslahah)* difficult to achieve.

Ahmed (2011) asserts that the *Maqasid* implies two sets of *Shariah* requirements, i.e., one legal and the other social, and advocates that this kind of activities is categorised as *Shariah* compliant product that will be one fulfilling the legal requirement but not the social requirements. Appropriateness of financial contract has an important role in helping the poor who started their business at an early stage. Accordingly, *mudharabah / musyarakah / qardul hasan* is most appropriate to be applied in the contract to encourage sharing of profits or losses will be borne by each party (owner of the funds and managers of business/poor people who start a business).

Issues and challenges in promoting BMTs in Indonesia

With regards to the issues and challenges in promoting BMTs, the respondents vary in their opinions. The first respondent holds the view that human capital who involved in BMT, the level of *Shariah*, regulation and the role of government are some issues faced by most of BMTs in Indonesia. He said:

> The main challenge that I see is in its management or the person who engaged in Islamic microfinance itself […]. Another challenge is the issue of Shariah […]. Actually our colleague in BMT is preferably few laws that regulates [...]. Some BMT what I see they are under OJK but if they want to be rather free, mostly are under cooperative. […] I do not see the role of government, in this case ministry of cooperative is more involved in BMT especially regulation issue of BMT (R1).

The justification of the human capital and regulation issues are further elaborated by respondent three. He stated that:

> The first issues is in terms of management. Yes we must realise that in fact, BMT still face lack of human resources. They are only based on spirit instead there is shortcoming in terms of operational level. […] BMT is like having two parents which both parents do not recognise them as their kids. This is due to no law that regulate them as a result BMT do not own guide with whom they must complaint when they face the problem (R3)

In support of the issues and challenges of BMT, respondent two adds that lack of capital is also considered a challenge of BMT to promote their role as Islamic microfinance in Indonesia. He mentioned that:

> What we wonder, we, BMT are currently like having no definitive legal umbrella. However, we are still under cooperative even though financial services authority (OJK) really wish to take over […]. Ideally, source of capital should be balanced between members and externals. But in fact, it can be said that mostly source of fund in BMT come from external source, in this case bank through linkage program. […] As a consequence, we are not really independent in

> making contract which that is why most contract used Murabahah (R2)

Regulation and lack of capital issues are also raised by respondent four who said that:

> In terms of Law, there are dualism laws, who's who to be regulator of BMT itself, OJK or Department of Cooperative […]. I think BMT capital must be strengthened, because if BMT only rely on saving, it is not much... So, BMT should have some fund resources to strengthen their capital. […] they gain highly margin (R4)

Moreover, the relevance of the role of government issues in this case of the Department of Cooperative officer lacking expertise in field of Islamic economics may be an issue to promote BMT in Indonesia. Respondent five said:

> Lack of capital issue as I just mentioned before, it is depending on investors that sometimes they come in with large capital. If BMT have no support for large capital, they, investors who have large capital will not be interested to invest their money into BMT. Both laws of OJK and Department of Cooperative really wish to take BMT to join either. […] while BMT is more comfortable under Department of Cooperative but they have lack of expertise, not only in local level but in national level, only few officers that understand about Islamic economics (R5)

To deal with the issue of regulation, there should be collaboration to synergise cooperative law between OJK and the Ministry of Cooperative about the BMT and microfinance. It is for that reason, respondent six stated that:

> OJK and Ministry of Cooperative is collaborating to synergise cooperative law issue, BMT or microfinance in general. […] OJK cannot apply BMT like commercial bank. In other side, Department Cooperative should not be so rigid to look at BMT only as cooperative entirely, meaning that there is no modification. […] the government has to be able to synergise poverty alleviation program into microfinance

> program and as I just mentioned earlier, other programs such as cash waqf, *zakat* and vice versa commercial sector. [...] if we speak about sustainability issue, not only talk about model issue that must be created a service of basis development that can support but they must attach one economic cluster for example in area of urban. They must go into UMKM cluster (R6)

Respondent seven stresses the importance of strengthening of human capital and regulation including public education that supports the development of BMT. He stated that:

> […] particularly in terms of regulation, it must be driven to be more regulation that support microfinance institutions. […] human capital […]. […] BMT is like investor which is in providing the financing they must know the characteristics of the customers (to whom to be financed), therefore, they must have qualified human capital and the third is public education. […] I hope the treatment of regulation for BMT is not similar to treatment of regulation for banking (R7)

The issues that emerges is human capital, regulation, the role of the government and lack of capital issues. The respondents believe that these issues and challenges are perceived as obstacles in promoting BMTs in Indonesia. The majority of the respondents believe that BMT faces a lack of regulation and supervision. Although BMT is a cooperative body, the government institutions like the Ministry of Cooperative Affairs do not recognise BMT as an Islamic financial cooperative (Seibel, 2007). As a consequence, the minister provides no information on and special assistance to Islamic cooperatives. On the other hand, since BMT is not perceived as a financial institution or micro-banking institution, it has no official relationship with the Central Bank of Indonesia (related banking and non-banking regulation and supervision are currently taking over by Authority of Financial Services-OJK) and the Ministry of Finance. Hence, the accountability of BMTs relies heavily on the sincerity and good intentions of the management (Antonio, 2011)

In terms of human capital, three respondents (R1, R3 and R7) agree that BMT also faces a lack of human capital. There are shortcomings in terms of operational level, lack of expertise both in *Shari'ah* and financial management, etc. Saeed et al. (2009) advocated that with the lack of

expertise, the practice of Islamic financing particularly *mudharabah* financing is not similar to what has been theoretically known. However, the *mudharabah* has practically become similar to *murabahah* as the Islamic MFIs bought goods requested by clients and considered them as an investment in the partnership. The clients repay the financing periodically.

Moreover, lack of capital and lack of government role are raised by some of the respondents. Instead of beneficiary savings, most of the funds for BMT depend on the external sources, such as through linkage programs with banks. As a result, in making financing contract, BMT is highly affected by investors. Agreeing with this, Ahmed (2002) found that Islamic MFIs are hampered by a lack of funds. Moreover, Ahmed indicates two problems in obtaining funds from external sources. First, the Islamic educational content of Islamic MFIs deters some external sources from funding them. Second, though some funds are available from government agencies, they impose certain terms and conditions. These terms and conditions not only limit the flexibility in the operations of Islamic MFIs but may also be contrary to Islamic principles. Additionally, lack of government role is perceived as an obstacle in the promoting of BMT. Some respondents claim the role of government, in this case, the Ministry of Cooperative in engaging BMT is relatively low.

Conclusion

Based on the results of this study, most Interviewees generally perceive that Islamic microfinance institutions (MFIs), in this case *Baitul Maal wa Taamwil* (BMTs) have low contribution to *maqasid Shari'ah*. They revealed that since most of the current practices of BMTs provide *murabahah* as the dominant financing, it is relatively hard to be in line with the *Maqasid Shari'ah*. The reason mentioned that Islamic mode of financing impose the clients with margins higher than conventional microfinance one. This indicates does not reflect justice or equal distribution income for the customer. Moreover, the dominance of third-party funds from large financial institutions on Islamic microfinance products has made the social mission of BMTs to the public interest (*Maslahah)* difficult to achieve. The study suggests that an innovative *Shariah*-based product realising the social goals may be one step towards achieving *maqashid Shari'ah*.

Additionally, the study also found that human capital, regulation issue, the role of the government and lack of capital issues are the most important issues and challenges faced by most BMTs in Indonesia. They stressed that

government institutions, in this case, the Ministry of Cooperative Affairs does not recognise BMT as an Islamic financial cooperative. Therefore, they provide no information on and special assistance to Islamic cooperatives. Furthermore, BMT is not recognised as a financial institution. As a result, there is no official relationship to the Authority of Financial Services (*Otoritas Jasa Keuangan – OJK*). To deal with the regulation issue, the study suggests the needs for collaboration among government institutions such as Ministry of Cooperative and OJK to synergise cooperative law regarding BMT and microfinance. This is to minimise overlapping financial cooperative rules

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