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MICRO FINANCE IN SHARIA RURAL BANKS IN INDONESIA: A CASE STUDY*

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Abstract. This paper aimed to identify the implementation of micro finance in sharia rural banks in West Java province, Indonesia. Furthermore, this study attempted to investigate issues found and the solution to them. Six out of 13 sharia rural banks in West Java, Indonesia were selected to be the subjects of the study. The selected banks were claimed to be able to represent urban and rural areas of the bank location. In addition, several experts and practitioners in related fields were also invited to be interviewed and attend a Focus Group Discussion (FGD). Based on the results of the study, it was found that the sharia rural banks found funding resource to be their ultimate issues in dealing with micro finance causing the shift in selecting customers from all people from low social class to those with fixed income. In addition, sharia rural banks also faced a tough competition with conventional banks, sharia banks, and sharia business units in having micro finance activities. There have been several efforts made to increase the quality of implementation of the micro finance yet the support from the government is still low. It is expected that the government creates such an effective system so that micro finance run by the sharia rural banks can be more effective.

Keywords: micro finance; Sharia Rural Bank; entrepreneurship; welfare

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1. Introduction

An inclusive business model, micro finance for instance, is proven to be able to enhance the economic potentials of developing countries (Husaeni and Dew, 2019), Indonesia is included. Micro finance has a positive impact towards poverty and social gap which are two of the biggest constraints of the growth of sustainable economy, (Kraemer and Conforti, 2009). Even though micro finance is not an absolute solution to eradicating poverty, it is, as long as it is well-structured and has optimum support in fulfilling specific needs of customers, believed to bring radical economic changes for poor population such as what happened in Nigeria (Fatukasi, 2005). Furthermore, there is a part of micro finance namely Islamic or sharia micro finance which also plays an important role in building socio-economic developments, particularly for micro businesses since it has no interests (or the so-called *riba*). The scheme of sharia micro finance is proven to have moral and ethical attributes which are effectively able to motivate micro businesses to develop. Both sharia banking and micro finance have close relationship since there are some elements of micro finance that can be synergized with the purposes of sharia banking (Rahman, 2007). In relation to this, policies made properly will be able to help the society have access to financial institutions (Allen et.al, 2012; Siddique et al., 2020).

Previous studies on finance and sharia micro finance commonly focus on the characteristics of the business runners as the financing objects and the sharia micro finance institutions’ mindset which are influenced by the notion of the difficulties of financing the poor. The studies revealed that the biggest factors of lack of effectiveness of micro finance in decreasing poverty are the poor customers and the financial institutions’ mindset (Fatukasi, 2005), (Obaidullah, 2008), (Van Rooyen, Stewart and De Wet, 2012).

Other studies put more focus on the perceptions and preferences of microfinance institutions on the services which are not optimum performed by Masyita and Ahmed (2011), Handayani, Haniffa and Hudaib (2018), Nasution and Ahmed (2015) and Nurfadilah, Samidi and Subagja (2018). And the institutions which are related to other institutions and associations such as zakat, wakaf, women empowerment, and so on. In general, the previously-related studies discuss more of the performance of the financial institutions, either banks or non-banks, including their micro financing using default level variables (measured by NPF), operational ratio efficiency (measured by REO), profit sharing margin, convetional bank interest rate, profitability ratio (measured by ROA), and luquidity ratio (measured by FDR, with recommendation of sharia financial industry; one of which is that sharia banking should enhance its performance). This research was conducted by Al Arif and Rahmawati (2009), Husaeni and Dew (2019), Trinugroho, Resfandy and Ariefianto (2018), and Afandi and A’yun (2018).

This study; however, focuses on the implementation of micro finance by sharia rural banks as well as its challenges and efforts made to cope with them in Indonesia. Therefore, this study aimed to describe the implementation of micro finance in sharia rural banks in Indonesia, its challenges faced, and efforts made to cope with them.

2. Theoretical background

Micro finance is defined as financing services for people with low income. This type of loan helps people have income, create an asset, manage risks, and fulfill their household needs (Husaeni and Dew, 2019). In this context, Islamic or sharia micro finance shares the same notion; the difference lies in that sharia finance does not only aim to have prosperity not only in the world, but also in the hereafter with the values of justice, benefit, volunteerism, and equality (Hassan and Kayed, 2009). Thus, in the practical level, sharia micro finance avoids some forbidden actions by Islam, such as *riba* (Khan, 2012).

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Sharia micro finance institutions have two primary functions; social and business. Those two functions enable the institutions to strengthen community-based economy (Oktafia, 2017). In Indonesia, sharia financial institutions show quite rapid growth. In the 1960s, the majority of Muslim Indonesians chose conventional financing; only a few of them, and they were usually from low income families, had financial transactions referring to sharia (Wilson, 2007). The growth of Islamic financicl insitutions in Indonesia is considered good in comparison with other countries with similar characteristics. This leads to the possibility of Indonesia in becoming the benchmark of sharia finance since Indonesia shows signifianct enhancement of funding and financing (Nengsih, 2015). The growth also has a positive effect to the development of small and medium enterprises indicating that capital investment plays an important role (Sobana and Husaeni, 2019).

In Indonesia, small and medium enterprises have quite huge contribution to the economic growth. The percentage is increasing from 1.67% in 2014 to 3.1% in the early 2017 (Pramono, 2018). Some of the strong factors to the increase are the high level of employment and low level of capital investment needed (Orlando and Susanto, 2019). Table 1 shows the total amount of funding of sharia rural banks based on the credit grouping:

Table 1. Total of Funding for Sharia Rural Banks Based on Credit Grouping

(in IDR)

Remarks	**2013**	**2014**	**2015**	**2016**	**2017**
Small and medium enterprises	2.620.264	3.005.856	4.215.989	3.570.603	3.919.714
Except small and medium enterprises	1.813.228	1.999.053	2.390.184	3.091.951	4.158.522

Source: Indonesian Financial Services Authority, 2013-2018
(https://ojk.go.id/en/kanal/syariah/data-dan-statistik/statistik-perbankan-syariah/Default.aspx)

In general, Table 1 shows that the funding by sharia rural banks has increased since 2013. It is supported with the easy access of the program. However, sometimes fluctuation happens due to the decrease of the society's economy (Hidayat, 2018). Financial inclusion is a process of giving a formal financial access to unbankable people. Sharia banking has a big potential to touch this area and has been proven to grow signifianctly (Nengsih, 2015). The development of sharia banking has given positive impacts for financial development in Islamic and Muslim-majority countries (Lebdaoui and Wild, 2016). It has been proven that the development of a country depends on the banking sector to help either individuals or groups (Orlando and Susanto, 2019). In Indonesia, there are three types of sharia banking including sharia banks, sharia business units, and sharia rural banks. Each type actually has its own purposes and functions. However, as time goes, some of their programs are overlapping (Buchori, Himawan, Setijawan, and Rohmah, 2003). In addition, Indonesia also has micro financial institutions specifically established to give funding to small and medium enterprises as well. All the Islamic and sharia micro finance institutions in Indonesia basically have two purposes; providing funding and promoting social motives (Baskara, 2013). Therefore, Indonesia has a quite complete series of financial institutions, particularly those having micro finance attempting to help low class people develop their business (Afkar, 2017).

3. Methodology

This qualitative phenomenologic study (Prastowo, 2011) aimed to explain the implementation of micro finance in sharia rural banks in Indonesia (Sekaran, 2006). The implementation of micro finance in sharia rural banks contained the requirements, procedure, and agreement used. Respondents of this study were employees of six (three were located in Bandung, the capital city of West Java province and the other was from Garut, Cianjur and Purwakarta, a developing city around 60 km away from Bandung whose rural banks have the second highest assests in the province) out of thirteen sharia rural banks from West Java, Indonesia, representing a total number of 160 sharia rural banks in Indonesia. The selection of West Java was due to the fact that it has been awarded as the top-six national sharia banking as reported by the Financial Fervices Authority (OJK) in 2017

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(https://ojk.go.id/en/kanal/syariah/data-dan-statistik/statistik-perbankan-syariah/Default.aspx). OJK stated that the growth of sharia banking assets in West Java is much as 15.8%. This number actually exceeded that of the national growth which is 10%. Thus, the six selected banks were purposively chosen since they meet the following three criteria: 1) all sixth are located in Regional 2 West Java with the highest assests and various non-financing performance (NFP) comprising the low, the moderate, and the high NFP and with various micro financing activities for small and medium-sized enterprises (SMEs).

The selected sharia rural banks were represented by the comissariat board and the chief of Indonesia Sharia Bank Association. In addition, there were several customers and academic invited to FGDs and interviews to confirm other types of data acquired. The FGD took place one time for five hours involving eight participants from the delegates of sharia banks, sharia rural banks, sharia bank association, academics, OJK, and customers. Each party was represented by one person except for the academics; there were six people representing. The interview was administered two months after the FGD (to the participants of the FGD) to go more deeply on the issue. The questions asked to the interviewees including issues related to the agreement, requirements, and procedure of micro financing in sharia rural banks as well as the challenges faced withing the banks and efforts made. Some of the interview was continued through emails when there were some points missed in the face-to-face interview session. The last type of data in this study was documents in relation to the topics being studied deriving from research results, websites, products, and implementation of good corporate governance of the banks. The data were triangulated and confirmed to three academics and relevant references (table 2).

Table 2. List of Sharia Rural Banks Selected as Respondents (Finance Director)

NO	Name of the Bank	Location	Respondents
1	Bank A	Bandung	1
2	Bank B	Garut	1
3	Bank C	Bandung	1
4	Bank D	Bandung	1
5	Bank E	Cianjur	1
6	Bank F	Purwakarta	1

4 Results and Discussions

4.1. The implementation of micro finance in sharia rural banks in West Java, Indonesia

The implementation of micro finance in six rural banks in West Java which are the samples of the study uses four types of *akad* namely *musharakah, mudarabah, murabahah,* and *ijarah*. All the four types of *akad* are in accordance with the costumers' needs and consequently have different administrative requirements. All of the *akad* types are also in agreement with the fatwa from the National Sharia Board (*Dewan Syari'ah National*, DSN) under the supervision of Indonesia Ulama Council (*Majelis Ulama Indonesia*, MUI). Such *akad* schemes as *qard al-hasan* (capitals need), *murabahah* (tool needs), and *ijarah* (tool rental) have the potentials to be easily managed for the finance for the poor. In the meantime, such participating schemes as *mudarabah* and *musharakah* have the potentials for the main purpose of micro finance since the scheme is able to fulfill the needs of risk distribution of micro businesses (Rahman, 2010).

In terms of *akad*, the most frequently applied are *murabahah*, followed by *musharakah*, *mudarabah*, and *ijarah*. For *musharakah* and *mudarabah*, the requirements are a filled form with several other required documents including a copy of ID card, a copy of family card, a copy of marriage certificate, and the recent photos of husband and wife. There are also additional document requirements covering a copy of business legality certificate, a copy of saving or checking account of the last three months, a copy of certificate of projects take, a copy of projects to be funded including the projection of funding of the projects, and a copy of guarantee. Regarding the business legality certificate, some of the banks require the costumers to have the business run for at

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least a year. For the *akad* of *mudarabah,* the obligatory administrative requirements ar the same and added with a copy of balance sheet of the past two years for employers and income statement for employees, the latest appointment decree for employees, a copy of guarantee, and the list of necessary goods. The costumers for the type of *akad* are then requested to submit the proposal of the goods they are buying and the dawn payment as much as 25% of the price set by the banj. *Murabahah akad* for comsumptive goods such as cars and home rennovation are mostly addressed to employees with fixed income such as certified teachers and lecturers.

Last but not least, the *ijarah akad* requires such additonal documents such as a copy of business legality certificate, a copy of saving and checking account of the last three months, a copy of balance sheet of the last two months, a copy of the latest income statement for employees, the latest appointment decree for employees, and a copy of guarantee. The costumers are going to rent the goods and finally own them since this is how the *akad* works. Those four different types of *akad* bring different types of profits for the banks as well. For instance, in the case of *mushakarah* and *mudarabah,* the banks are benefited from profit sharing. As for the *murabahah*, the banks are benefited from the margin setting and for *ijarah*, they receive the benefit from the rental fee. In addition, all the four types of *akad* are categorized into *tijari,* whose main purpose is to have profit. Thus, the requirements usually request for a guarantee to the customers.

The costumers are either individuals or groups. In Islam, this is not something new since ibn al-Khald stated that it is a part of social solidarity so that sharia banks offer a variety of products of sharia finance without questioning the sustainability of the groups (Dusuki, 2006). It has been found that some of the requirements of the micro finance are actually difficult for the poor people; in fact, the ideal purpose of the finance is to fund micro small and medium enterprises. In the meantime, it is shown that the rural banks with low assets are concerned with facilitating the society yet those with high ones focus more on consumptive funding. This indicates that micro finance has a stroght economic basis. This is in line with a study in Africa proving that micro finance has a positive impact towards eradicating poverty (Van Rooyen, Stewart and De Wet, 2012).

There is a shift of the function of sharia rural banks from helping low social people to helping those with secure income. This is due to empirical data showing that traditional financial industry claimed that small loan is related to big risks and vice versa. In Africa, for instance, small and medium enterprises have difficulties to access micro finance. Some of the contributing factors to this phenomenon are commercialization and private investor involvement (Li, Hermes and Meesters, 2019). Micro financing is such a difficult task to do since the institutions have to be able to provide funding for small enterprises without having too much loss. One of the strategies to deal with it is collaborating with other institutions. In Nigeria, micro financing has been more effective when combined with other activities, particularly women empowerment activities. In Indonesia, it has also been proven that women empowerment plays an important role in enhancing employment and export (Sobana and Husaeni, 2019).

An integrated model combining Islamic financial institutions and philantropic bodies are very feasible to implement in Indonesia. Both the institutions are able to complete each other (Hassan, 2010). Thus, the implementation of micro financing in sharia rural banks is not limited to loan with sharia interests. Some other programs such as zakat, waqf, and sadaqah are applicable as well. In terms of asset growth, there is a fine increase even though quantitatively, the percentage is 62% in the last three years. With the percentage of refund as much as 92-93%, the fluctuating non-performing finance ranges from 2%-5%. Thus, it can be inferred that sharia rural banks have a potential to the country's financial contribution (Kara, 2013). Globally, Islamic financial industry is developing; however, there needs to be an upgrade of innovation and an additional feature accommodating such instruments as zakat, infaq, sadaqah, and waqf to be better organized. The mindset of the difficulty to differentiate the low social and economic class people is changed by the success of sharia rural banks in micro finance.

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4.2. Constraints in Sharia Rural Bank micro finance in West Java

Generally, there are three main obstacles of the implementation of micro finance in sharia rural banks in West Java. *First* is the financial resource. According to the head of Indonesia Sharia Bank Association, this is the prioritized issue in micro finance since the financial resources from deposit saving or the third party do not meet the needs (Purba and Teriana, 2017). One of the possible solutions is by having loan from other sharia banks. However, a new problem arises as the cost of fund (COF) is pretty high. *Second* is the existence of competition between sharia rural banks, sharia banks, and sharia unit which share the same program in having micro finance. It has been found that some of the programs they have are overlapping; in fact, the amount of funding they have is totally different. Sharia rural banks tend to have smaller amount in comparison with the other two competitors. Costumers usually are more interested in proposing to have micro finance services to banks with easy access. Thus, sharia banks should improve their performance and learn a lot from conventional banks (Masyita and Ahmed, 2011**)**. This is a possible solution since basically there is no huge difference between both banks in poverty eradication (Obaidullah, 2008). *Third* is the economic stability. Small enterprises usually cannot maintain their business when what they trade is seasonal meaning that their income is not stable. However, the most important factor in the early stages of small enterprises is capital investment, followed by technological innovation (Li, Hermes and Meesters, 2019). It is found that one of the challenges of micro finance is low penetration of the business, lack of funding mobilization and high administrative cost (Rahman and Dean, 2013).

Governments are in need of making policies in relation to micro finance particularly in sharia rural banks. It is inevitable that the changes in the banking world such as tight competition and private investment are big constraints (Oktafia, 2017). In Islamic countries or countries with Muslim majority, most of the community members are unfortunately categorized poor. Thus, sharia finance should be well organized (Rahman and Dean, 2013). Some of the ways to cope with this are developing a central sharia bank, researching on important issues, and inreasing the people's awareness to invest in micro finance (Rahman, 2013). In Indonesia, the government needs to reevaluate the policies of sharia banks having a right to conduct micro finance since it has a negative impact to the sharia rural banks.

4.3. Efforts made to increase micro finance in Sharia Rural Banks in West Java

The first effort made is related to the cost of fund. The sharia rural banks have attempted to have fast responses and easy requirements for micro finance. However, the feasibility analysis should still be paid attention. Another effort is by having the supervisors come to the customers' house no matter how small the finance is. This is beleived to create psychological bonding as well. Unfortunately, some of the banks have an issue of the human resources. Micro finance is defined as financial activities for low social and economic class people who have limited access to the banks. Thus, this type of costumers usually do not have guarantees, fixed income, and any other administrative requirements (Baskara, 2013).

In relation to the issue of capital investment, the government should make a policy supporting the small and medium enterprises. In addition, the development of human resouces also plays an important role in improving the quality of micro finance (Saragih, 2019). Based on the findings of a study by Nugroho (2019), human resource development is a priority in comparison with poverty eradication. More specifically, a segmentation of customers between sharia rural banks, sharia banks, and sharia business units is urgently required. Banking-related institutions are to provide financial services and voluntary institutions are to have such programs as zakat, infaq, waqaf, etc (Rahman, 2013). It is believed that integrating those two kinds of institutions are a great weapon to reduce poverty in such developing countires as Indonesia, Malaysia, and Bangladesh (Haneef, Pramanik, Mohamed, Muhammad, and Amin, 2015). The principles of social and Islamic finance should be maintained to have solid micro finance aiming at reducing poverty. Using zakat funding to have more social programs is a great notion to have a more efffective way of poverty reduction (Yumna and Clarke, 2011). In Indonesia, some policies actually contradict with others. For instance, a policy on who has the right to conduct micro finance activity is quite controversial.

Conclusions

Micro financing, particulalry one conducted by sharia rural banks in West Java, Indonesia, is intented to be able to help people from low social and economic class to develop. It is commonly known in Indonesia that those people do not have an easy access to banks, either conventional or sharia ones. Thus, sharia rural banks are expected to cope with this. However, in the implementation, there is a slight change. Sharia rural banks whose main purpose is to help the government reduce poverty by giving easy access of micro finance to the poor are now focusing on having customers with fixed income. One hand, it is understandable since the funding resource is still the number one problem in the development of sharia rural banks. On the other hand, however, this cause to lesser chances of the poor of getting financial help. Unfortunately, in terms of policy, Indonesian government seeems to be too loose since there are several policies contradicting with each other. Thus, it is expected that there is a systematic change leading to an integrated model of micro finance in Indonesia.

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