

The Implementation of Musharaka wal Murabaha for Shariaa Rural Banks
in
North Sumatra as part of Community Development Program

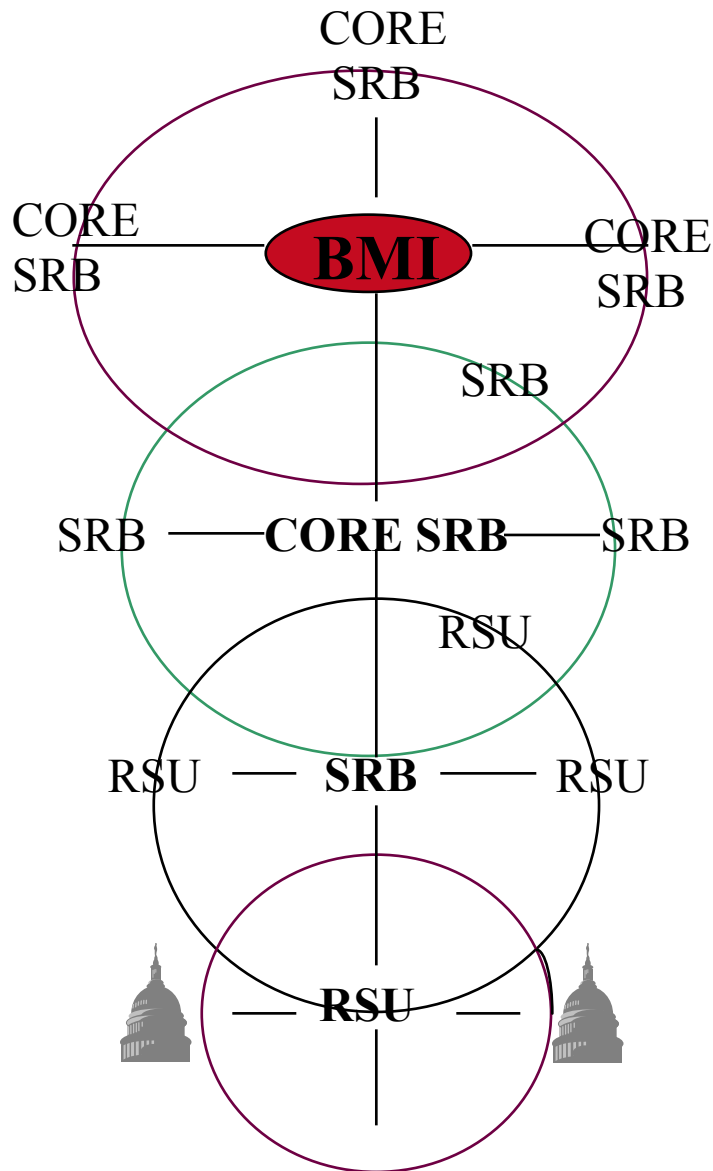
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Islamic Financial Institution Role in Indonesia Economy

The restructuring of the governmental organization and the banking industries in Indonesia leave a big social problem to the country. The jobless people have to find a new pattern of life income in order to survive. This was a starting point of transformation in Indonesia economies and businesses. The new paradigm of monetary crisis in Indonesia has widen a new opportunity of Small and Medium Enterprises (SMEs) for people in the rural area especially the community-based industry. The retail businesses are recently mushrooming everywhere. The former banker now become a street-food seller, the former government officer become an outsource company for the government office, etc. The big cake (monopoly) has been sliced in to pieces and now become smaller companies with a better quality and price for customers. The growth of SMEs has also influenced the growth of financing demand. The Islamic Financial Institution (**IFI**) becomes an alternative for these new entrepreneurs. They believe the strength of Profit and Loss Sharing (**PLS**) concept has saved the IFI from the sharp fall of banking industries due the negative spread and economic crisis.

Indonesia is recently the country with a big number of Islamic banks. The role of **IFI** in Indonesia is split up into three institution; Shariaa Bank (**SB**), Shariaa Rural Bank (**SRB**) and Rural Saving Union (**RSU**). The numbers of SB, SRB, and RSU has grown fast with a total of **6 SB, 81 SRB and 600**

RSU. The distinction of these IFI is in the equity and the financing capacity. This has made a pattern of effective distribution of services to the various **BANK MUAMALAT NETWORK WITH OTHER ISLAMIC FINANCIAL INSITUION**




BMI : BANK MUAMALAT INDONESIA

SRB : SHARIA RURAL BANK BANK

CORE SRB : CENTER OF SRB

BMT (RSU) : BAITUL MAAL WA TAMWIL OR (RURAL SAVING UNION)

 : MASJID

Different market segment within the IFI services network. **Bank Muamalat Indonesia (BMI)** as the pioneer in SB is become the motor in transferring the know how of Shariaa products to the SRB. And SRB is expected to do equal responsibility to the RSU development. The diagram shows how the IFI works within the scale of business and market segment. BMI works on the financing support range between IDR (**Indonesian Rupiahs**) 50 million (USD 5000) and above, **SRB** works between IDR 5 million and above, **RSU** can carry out financing start from IDR 500 thousands (USD 50).

Nowadays the role of BMI is not only in banking services but is also in financial consultant for customers, strategic partners for other IFI, payment point for public services company, and agent of change for sustainable development and environment that give positive impact toward the society. In supporting the growing demand of human resources for IFI, BMI in cooperating with several universities has also developed a non-degree and a degree programs that can enrich the knowledge of Shariaa and management for professionals who already in IFI and who consider to move from conventional banking industry. The Dual Degree Program and Certified Islamic Finance Analyst have created a new horizon for the economic studies in Indonesia. BMI has formed a foundation called Muamalat Institute (MI) to carry over these programs.

Rural Banks in North Sumatra

The Sharia Rural Banks pioneered the development of Shariaa Institution in North Sumatra since 1994. There are five Shariaa rural banks (SRB) amongst the total 55 rural banks that provide micro-credit services for the lower middle economies. Their customers, Small and Medium Enterprises, mostly produce goods (bags and garments) and traditional food (chips and street-food seller). Others work in services sector such as commodity trading, back peddler, and small class contractors. The Capacity of SRB business in North Sumatra is varied due to several factors: Capital provided by the share holders and investors, Management Skill, Market Penetration, and Human Resources competence toward Shariaa Products. With the start up capital range from IDR 200 million to 500 million (USD 20.000 to 50.000) the rural banks has recently growth with the Total assets between IDR 1 billion to 5 billion (USD 100.000 to 500.000). The Return on Investment per share has reached 20% pa. The fast moving (highly turn over) product as the nature of the community based business can generate return up to 40% p.a. Margin expected by SRB to their customers is relatively bigger than the public and private banks offered. On the other hand the SRB legal and credit requirement are less than a conventional bank.

On the other case customers expect the return of their Mudarabah time deposit (savings) is bigger than the interest margin offered by the conventional bank. While on the other hand they expect the margin cost of Murabaha financing (credit) is smaller than conventional banks. Therefore, the product of IFI is more accepted by the emotional market with the

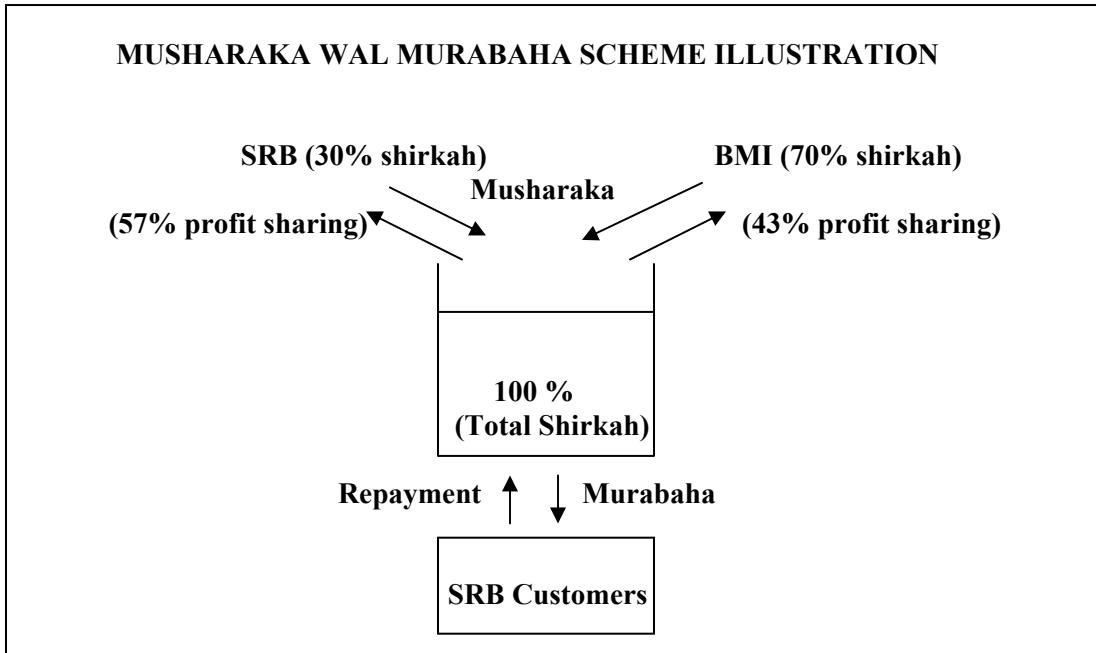
motivation driven by religious concern. And it has rapidly changed to the idea of giving appropriate services to the customers at their convenience.

Case Study of 4 (four) SRB Supported by Bank Muamalat Indonesia

In this paper we examine the case study of Bank Muamalat Introduction of the Musharaka wal Murabaha Facility to the four North Sumatra SRB. This is a continuation of the previous programs, which are equity participation and direct placement. The objectives of Musharaka wal Murabaha Financing are to provide adequate fund for the SRB financing expansion and to increase the Earning Assets in a short period. This facility will help SRB to overcome the regulation of legal lending limit and liquidity required by the central bank due to the SRB financial capacity and paid up capital. In addition this facility can create fee based income for SRB.

The Musharaka Wal Murabaha

The Musharaka concept works on the cooperation of BMI and SRB in providing financing facility to SRB customers. The transaction between SRB and their customers will be structured as Murabaha. SRB will conducted the sell and buy transaction with deferred payment to the customers where they expect to earn a certain amount of margin. The SRB is acting as an executing agent of BMI and SRB will take all the possible risk occurred for their customers. In return BMI will expect to have an effective financing distribution for the SMES by channeling the facilities thru SRB and will receive a profit sharing ever month from the SRB customers. Below the Musharaka wal Murabaha scheme illustration.



The Musharaka Facility

Basically this is a price blending of BMI and SRB where SRB will get the advantage from the lower pricing rate of BMI. The Musharaka Facility can provide fund for the SRB with the maximum of 2 times fold their paid up capital. The fund distribute from BMI will equal to 70% of the total shirka (total financing disbursed to the SRB customers) and the other 30% will be taken from the SRB fund. The BMI financing facility is expected to reached yield of 22% p.a. effective and SRB will sell it for the minimum of 36% pa effective. The profit sharing ratio between BMI and SRB is 43%: 57% of the total revenue received every month. Since the third party's fund used by the SRB for the shirka is only 30%, SRB then will post the 27% profit as the

additional fee based income (miscellaneous income). This is posted as fee based income since the third party fund contribute to shirka is only 30%.

The Musharaka facility is distributed for SRB with loan to deposit ratio (**LDR**) above 80%. The objective of the 30% shirka of SRB is to give the ideal partnership that allows SRB taking responsibility of the facility drawn for the customers. Beside, the opportunity for SRB to get appropriate income from shirka where BMI act as the supporting party.

The formula of profit distribution for SRB and BMI is determined with these assumptions:

1. Margin rate (yield) expected by BMI is 22% pa (at minimum)
2. Effective yield expected by SRB from customers is 36% p.a. (at minimum)

These assumptions then will be calculated to get the portion of profit distribution:

BMI profit distribution portion = $22/36 \times 70\% = 43\%$

SRB profit distribution portion = $100\% - 43\% = 57\%$

SRB submit the list of collective customers that indicate the total possible shirkah formed. SRB propose the 70% portion to be disbursed by BMI as SRB financing facility Plafond at the Bank. BMI then will form the structure facility below (for example):

Musharaka Facility Structure for SRB

BMI Shirkah	: IDR 800.000.000,-
Utilization	: SRB working capital (Total plafond IDR 1.143.000.000,-)
Tenor	: 36 months
Musharaka Ratio	: BMI : 70% ; SRB : 30%

Profit Sharing Ratio : BMI : 43% ; SRB : 57%
Administration fee : 1 %
Disbursement : Subject to proposed financing facility from
SRB customers

These are several requirements that should be submitted by SRB subject to disbursement:

1. List of SRB customers proposed to BMI with detail information of Plafond, Type of Business, tenor, objective of utilization, and address.
2. Copy of Agreement between SRB and Customers.
3. Schedule of repayment to BMI.
4. Administration cost for BMI (1%)

The Murabaha Facility

The transaction occurs between SRB and their Customers is Murabaha. SRB will conduct the sell and buy transaction with the customers of some goods as the object of Akad (agreement) and it will be paid in deferred payment within a pre agreed tenor. SRB is expecting to earn a certain amount of margin. SRB will disburse the fund to the third party who is acting as the vendor or supplier of goods bought by customers. There are 2 SRB that the Murabaha is dominated with consumptive financing. This is usually focus on helping employees of government institution or private company to have investment such as motorcycle, housing, etc. Tenor on these 2 SRB is longer than the others, which can reach 36 months.

The other SRB launch the Murabaha for working capital financing. The facility introduced by BMI last year was a month before Ramadan (fasting month of Muslim) where most people is looking forward to celebrating Eid-

ul Fitri (Feast day of Muslim). These two months the consumptive goods demand will increase very high. Ramadan is the moment for SRB to offer financing facility to the garment home industry, groceries, food sellers, transportation business, for their working capital. The tenor of the financing will not exceed 6 months. The customers will only pay part of the installment, which is negotiable and depend on the business cash flow (Grace period). And they will pay the entire installment obligation at the maturity date of facility. SRB customer sometimes requests to revolve the initial facility they get. In this case BMI will also facilitate SRB with Revolving Musharaka. BMI will also consider this facility as a working capital financing that can be disbursed within the period of Musharaka Facility Agreement which in this case for 36 months. Here we show you Murabaha Facility structured for consumptive financing.

Murabaha Facility Structure for SRB's Customer

Plafond	: IDR 50.000.000,-
Utilization	: Working capital for jeans production
Tenor	: 36 months
Grace Periode	: 2 months
Buying Price	: IDR 50.000.000,-
Selling Price	: IDR 82.446.820,-
Margin	: 36 % effective p.a.
Installment per month	: IDR 2.290.190
Administration Fee	: IDR 500.000,-
Disbursement	: Based on production schedule

Results

The Musharaka wal Murabaha for SRB start since September 2000. We give you the data from December 2000 until April 2001 where all SRB have already start paying the profit sharing to BMI. We also show you the market

share of SRB to the Total Financing Portfolio of BMI Medan Branch by 31 December 2000. Here in the table we can see the Yield Ratio in percentage. The Yield Ratio is the Profit Sharing obtained for BMI divided by the Outstanding of Facility of SRB at the end of month. We also calculate the assumption of Yield Ratio per year.

SRB Yield obtained in monthly and assumption for yearly

SRB	Dec.	Jan.	Feb.	Mar.	April	Aver.	p.a.
Gebu Prima	1.51	2.05	1.54	1.58	1.58	1.65	19.82
Puduarta Insani	2.16	2.17	2.24	2.18	2.28	2.20	26.47
Al Washliyah	1.86	1.86	2.78	1.89	1.89	2.05	24.67
Rahmah Hijrah Agung	1.78	1.75	1.78	1.78	1.78	1.77	21.29
Average	1.83	1.96	2.09	1.86	1.88	1.92	23.06

Here we can see that Gebu Prima (**GB**) is more fluctuated in Yield produced per month. GB has IDR 3.4 billion assets (USD 340 thousand) focusing the business for working capital financing. The shirka with BMI was disbursed for the 3-6 months business during Ramadan. After Eid the business is slowing down and the utilization of fund is not that optimal. BMI consider revolving the facility in March to anticipate the increase demand on April for school holidays (summer). The character of their customers business is garment producers, services, car repair and consumer goods retailer. GB situation looks similar to Rahmah Hijra Agung (**RHA**) where the actual situation RHA distribute the Murabaha facility to the Employee Financing with the competitive “margin” to the conventional banks at that area. The expected selling margin of 36% can reach the number. Therefore their business has big volume and slight margin obtain. The total assets of RHA

has now reached IDR 7.3 billion (USD 730 thousand) from the BMI facility received of IDR 900 million (USD 90 thousand).

On the other hand Puduarta Insani (**PI**) and Al Washliyah (**AW**) focusing the business for consumer financing, where the customers have fixed schedule of payment within a longer period (up to 36 months). At the beginning they will obtain significant return from the installment (effective yield). This would help the Earning Assets for the short period. Then the repayment of principal will have a bigger portion at the end of period. In order to overcome the reducing income they ask BMI to revolve the facility received in the second semester of this year. Therefore yield will raise up again to contribute profit for this year performance.

Below we show you the Plafond given to SRB, Profit Sharing obtain for BMI and the Line Credit Unused (LCU) on 31 December 2000.

SRB	Plafond (IDR)	Profit Sharing (IDR)*	LCU (IDR)
Gebu Prima	800.000.000	16.705.500	18.500.000
Al Washliyah	170.000.000	2.064.000	58.000.000
Puduarta Insani	250.000.000	9.639.671	1.500.000
Rahmah Hijrah Agung	900.000.000	21.422.210	
T O T A L	2.120.000.000	49.831.381	78.000.000

* Profit Sharing received since September until December 2000

The Profit Sharing received (IDR 49,831,381) compare to the outstanding total facility used (IDR 2,042,000,000) produced percentage of Yield 2.44% per month. This number is excluding the repayment of principle during that

period. There is IDR 78,000,000 facility that in LCU position which is 3.68% from the total plafond given to the SRB. SRB will do the prudent banking approach to absorb all credit proposals from customers. Beside they would consider that financing facility needed after Eid was not effective any more to create profit sharing for the end of year performance.

Conclusion Remark

The Network between BMI, SRB, and RSU has several barriers that need to be improved. One of them is the operational coordination with government institution is different between SRB and RSU. The establishment letter of SRB is given by Finance Ministry where SRB gives the regular financial report to central bank every month for the operational monitoring. On the other hand RSU under a legal body of cooperatives reports the performance to Cooperatives Ministry yearly. The establishment of RSU itself has to be approved by the central of small-scale business development. And there is no coordinating plan between Finance Ministry, Cooperatives Ministry, and Central Bank in developing the working system between these community financial institution that can work well for developing small businesses in rural area. Therefore Bank Muamalat, beside other Shariaa banks that should involve, take the responsibility to manage the network development and to accommodate the financial support appropriately by considering each institution competence.

The model of Musharaka wal Murabaha for SRB will accommodate the facility of other Shariaa transaction such as Istishna, Bay Al-Salam, and Ijarah where are not familiar and popular to the SRB system. The

Musharaka transaction between BMI and SRB can acquire both goods and services transaction. For SRB that has larger capital capacity, the business focuses on working capital financing support to the business that has features of high asset turn over and shorter period cycle. This is a kind of business with big volume and small margin. Tenor will range between 3-6 months. And it is structured in revolving based by BMI, but the disbursement based on the project proposed in every new financing acquired.

The advantage of Musharaka wal Murabaha scheme:

1. Increase the cooperation with Shariaa Rural Banks both Financial Assistance and Technical Assistance
2. Distribute the facility to a bigger number of customers with various different needs effectively.
3. Spread risk to smaller accounts.
4. Give benefit to the community development (social motivation)
5. Improve the “two step”-banking banking techniques to SRB toward other IFI such as Rural Saving Union.
6. Create additional fee based income
7. Increase the quality of the SRB portfolio.
8. Increasing customer base.

The advantage of Fee Based Income for SRB:

1. Increase profit at miscellaneous income post
2. Increase BMI return in which SRB sell above the minimum margin expected

Factors (variables) determine the Yield number:

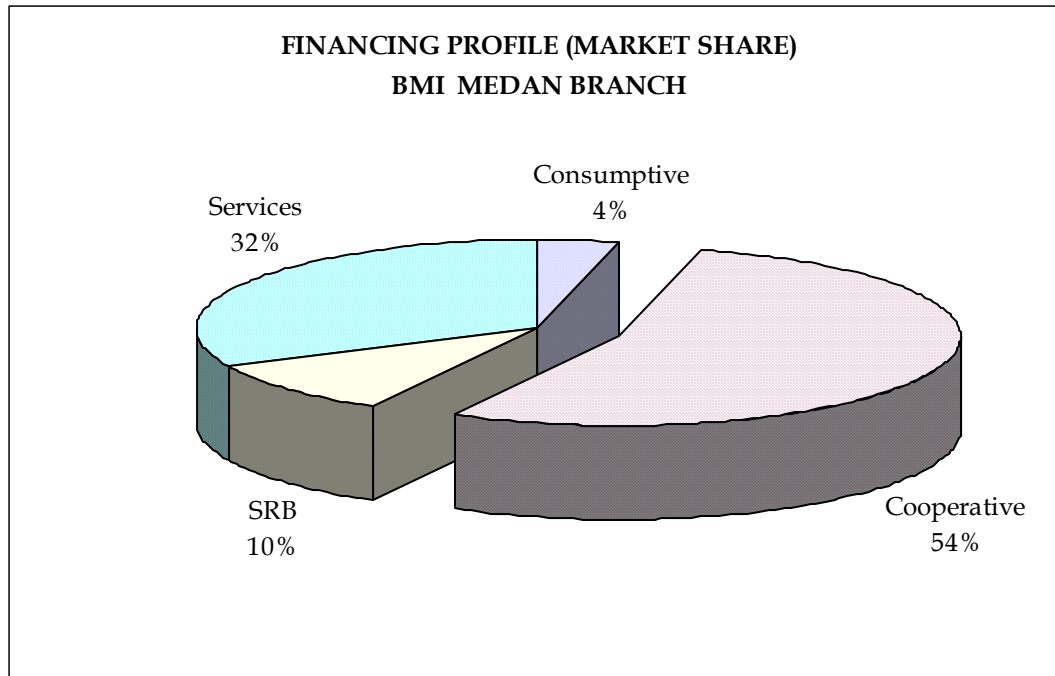
1. Type of facility: working capital and consumptive
2. Installment schedule: Principal and Margin

Mudharaba and Musharaka dominate more than 50% of BMI Medan Branch Financing portfolio. SRB took IDR 2,120,000,000 or 37.39% of the total Musharaka portfolio. The Employee Cooperatives Financing Facility absorbs the Mudharaba product. The model is Mudarabah wal Murabaha where BMI is facilitating the consumer credit demand of the Cooperative's member. The fix income of Murabaha comes from the employee salary that is deducted every month for repayment to Cooperatives. And it will repay collectively by cooperatives to BMI.

Financing Products and the contribution to the total portfolio per 31 December 2000

Products	# Acc.	O/S (IDR)	%	Target Market
Al Mudharaba	7	9.071.338.740	41,4	Company Coop.
Al Murabaha	21	3.669.828.574	16,6	Retail & Konsumtif
Al Musharaka	7	5.668.881.409	26	BPRS & Corporate
Bank Guarantee	1	3.500.000.000	16	Non Cash Loan
Total	36	21.910.048.723	100	

The figure below shows the contribution of SRB Financing Facility to the total market share. Cooperative takes the bigger number compare to SRB, Consumptive (consumer banking), and services. Consumer banking is the Murabaha product of Auto, Housing, or House Renovation Financing. Services are the product of Murabaha or Mudarabah to finance a company that produces services to the market such as: laundry, car rental, etc. Usually this company needs some investment to enlarge the business.



Suggestion for Collective Micro-finance Development

1. Community Stakeholders Identification in Targeted Region thru Participatory Appraisal Approach: Use Existing Community Institution.
2. Concept Socialization in 6-12 months: Market Awareness and Development of community member (Agent of Change)
3. Program Implementation: Financial Assistance accompanied with Management and Technical Assistance.
4. Be Selective to choose a good character and competence customers.

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