

REGULATORY COMPLIANCE AND EXPERIENCES OF ISLAMIC COOPERATIVES IN COMPETITIVE BUSINESS IN INDONESIA

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Abstract

Purpose – The paper aims to analyze the compliant level of Islamic cooperative to related regulations. In addition, it proposes to explain how Islamic cooperative can compete in a difficult business environment. It has unique model of Islamic financial institution which aims to help poor people to avoid conventional banking system.

Design/methodology/approach – The paper is based on purposive sampling and reliable data objects. 14 samples from 34 are taken from Islamic cooperative available. The data are on primary obtained by interview and questionnaires. The questionnaire is based on compliance check on stated regulations with additional information, likert scale, and essay format. Basically, Islamic cooperative is strengthened by Ministerial Regulation issuance in 2004, followed by its monitoring and supervision regulation in 2007.

Findings – The paper provides empirical insights about Islamic cooperative may not be complied due to unclear accountability and procedure. Besides, this institution must compete to other established conventional financial institutions.

Research limitations/implications – Sample is only limited in Depok city, West Java, there should be random sample spread out of all Indonesia region to get finding conclusions in general.

Practical implications – Only Islamic cooperative whose has an effective strategy and captive market can survive from this competitive business. Some important factors must be fulfilled in order to develop and to exist in tough business environment.

Originality/value – This paper may be the first paper which discusses the compliance issue with related regulations and their business strategy to survive and to face problems in Indonesia.

Keywords: Islamic Cooperatives, regulation, competition, Indonesia, economics

Article Type: Case study

Introduction

Legally, Islamic cooperative has been formalized since 2004 when Ministerial Regulation Nr. 91/Kep/M.KUKM/IX/2004 on Guidance on Islamic Financial Service Cooperative Activity issued. In fact, similar Islamic microfinance institutions had already been established before this regulation issued. For example, *Baitul Maal wat Tamwil* (BMT), it means house of wealth and business, in Indonesia translated as “Balai Usaha Mandiri Terpadu”. It is derived from the concept of “Baitul Maal” in the period of Prophet Muhammad PBUH. Then, it is developed to empower economic and business activity of society or organization, known as “Tamwil”. It is supported by organization, *mesjid*, school or office. This is the reason why Islamic microfinance institutions always appear in numbers every year. Thus, the back up and support of BMT from organization can assist them until become independent.

Usually, BMT only run business (Tamwil) activities which mean they operate like a bank in order to generate income. In order to cover the operational expense, it needs big enough of investment to achieve the economics of scale as well as the optimum margin. This can be a big problem if the capital or asset is still small, they have to raise up to achieve the economics of scale. It would not be so easy to increase capital as it may violate the banking regulation and problem in the legal status of BMT (which is under cooperative basis) may not absorb fund directly.

The term BMT may shift to Islamic cooperative which has a legal basis. In this case, three regulations were issued to give guidance on operational standard and monitoring for Islamic cooperative, they are:

- a. Ministerial Decree Nr. 35.2/Per/M.KUKM/X/2007 on operational standard for Islamic Cooperative
- b. Ministerial Regulation Nr. 35.2/PER/M.KUKMI/I/2007 on operational standard for Islamic Cooperative
- c. Ministerial Regulation Nr. 39/PER/M.KUKMI/I/2007 on monitoring guideline for Islamic cooperative

The implementation of these regulations would be extremely interesting topic to be discussed. The regulations itself require a high standard of requirement for Islamic cooperative level, in addition, some issues raised also would be explored in more detail. Especially some experiences of Islamic cooperative will be faced and on how to survive in the competitive business in Indonesia. A depth interview basis conducted to get more information on this issue.

Regulations of Islamic Cooperative and its Experiences

Story of Regulations for Islamic Cooperative

In case of Islamic cooperative, it might be established since 1896 when Patih R. Aria Wiriatmadja promoted cooperative system in Purwokerto, Central Java. In addition, there was Islamic Trader Union (Serikat Dagang Islam) established in 1905 which based on Islamic teaching and the economics of society. The leader was Haji Oemar Said Tjokroaminoto, he wrote a book on the titled of “Islam dan Sosialisme” in 1924. He stated that *riba* was prohibited in Islam and similar to *woeker* means Islam is against to the capitalism.

After the World War I until 1990s, there might be no Islamic business activities or no record on them. This could be caused by the political turmoil by the colonialization and after the Independence Day in 1945. This affected to the economic practices as they may not aware of Islamic teaching compliance. From 1945 until 1966, Indonesia faced disintegration and rebellion from other regions. This caused economic tension, at that time there was a food and natural resource scarcity such as gasoline, kerosene and basic needs. While, from 1966 until 1990s, Indonesia was dominated by the capitalism system which was secular. It was prohibited to have

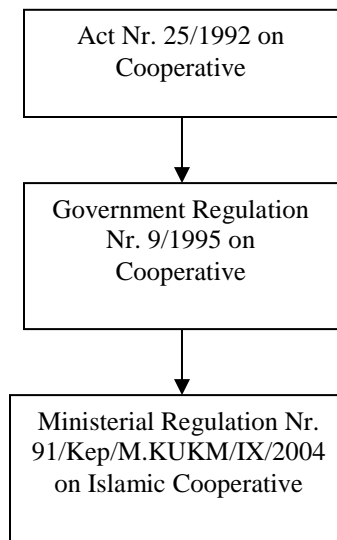
economic and political activities based on Islamic teaching. Islamic teaching was banned to be practiced or combined in daily life activities, it only permitted in the form of God's worship.

The first formal Islamic financial institutions were established in 1992, three Islamic rural banks (Bank Pekreditan Rakyat Syariah – BPRS) established; namely BPR Dana Mardhatilla, BPR Berkah Amal Sejahtera and BPR Amanah Rabbaniah (Sumitro, 1996). Then Bank Muamalat as the first Islamic bank set up in 1992 in the era of liberalization of banks without Act for Islamic bank. But Act Nr. 7/1992 permitted profit sharing scheme in bank activities. Then Act Nr. 10/1998 was issued; the Act permitted a bank to have Islamic activities in units as well as the full fledged system. Then, Indonesian Bank regulation No.8/3/PBI/2006 may allowed Islamic unit in conventional banks to serve in some branch offices. Lastly, Act No. 21/2008 is issued for Islamic bank, this Act still allowed operating either under the units or a full-fledged Islamic banking system.

Compared to the Islamic banking regulation development, the government issued Government Regulation Nr. 9/1995 which permitted for a cooperative activity guideline but not explicitly to run Islamic business activities. However, similar cooperative or BMT already established by members of masjid Salman ITB in Bandung with the name of “lembaga Teknosa” in the period of 1980s. Then, there was Koperasi Koperasi Ridha Gusti in 1988 in Jakarta, which used profit sharing basis. Then, the first formal BMT established in 1994, namely BMT Bina Insan Kamil in Jakarta. Then, many BMT trainings were offered by Pusat Pengkajian dan Pengembangan Usaha Kecil (P3UK). It consisted of BMT Bina Insan Kamil's founders. Afterwards, BMT became so popular at that time. Then in 1995, it officially was fostered by Micro-Enterprise Incubation Center (PINBUK), supervision of Indonesian Association of Muslim Intellectuals.

As BMT did not have a formal and explicit supervision from the government at that time. So, regional association sprang up for example, Surakarta's BMT Association, Klaten's BMT Association, Wonosobo's BMT Association etc. Then, in national level there are BMT center in Jakarta, established by 96 BMT on 14 June 2005, Central Java's BMT Association in July 2005, and Indonesian BMT Association (ABSINDO) in December 2005, which approved in BMT National Congress by all BMT in Indonesia. Currently, BMT actually becomes part of Islamic Cooperative in order to be recognized on the legal basis from the government.

Figure 1. Hierarchy of Islamic Cooperative Regulation



For Islamic cooperative, it was regulated under Ministerial Regulation Nr. 91/Kep/M.KUKM/IX/2004. Compared to Islamic bank, Islamic cooperative is ruled only under Ministerial Regulation, and it had longer responses from the government to be regulated for Islamic scheme.

Experiences of Islamic Cooperative

Islamic Cooperative has a captive market which can be from the regional society, company's employee or traditional market seller or organization's member and public type. If they can optimize their captive market, it can generate income at least to cover operational expense or perhaps to achieve optimum net margin. For close membership type, such as under the company or organization, Islamic cooperative can grow more sustainably and steadily than open membership type such as in regional society, traditional market and public's membership.

Based on PINBUK there were almost 3200 BMT in the mid of 2006 with a total asset of Rp 2 trillion from Rp 1.5 trillion in December 2005. It served 3 million people or clients. Afterward, the numbers of BMT increased along with the population growth in Indonesia. At the same time, conventional bank experienced in decelerating growth both in asset and loan. This might be caused by supporting institutions (such as PINBUK, Dompot Dhuafa, Baitul Maal Muamalat (BMM), Islamic finance institutions) as well as the community surroundings and society.

There is also ranking system for cooperatives in Indonesia, which based on performance system (Ministerial Decree Nr.X /Kep/M.KUKM.2/II/2008 on cooperative ranking). However, it seemed not all cooperatives included in this ranking system. This can be a reference for society to be part or member of Islamic cooperative.

Research Methodology

The paper evaluates the regulations of implementation compliance on Islamic cooperatives specifically in Depok (see figure 2) based on three specified regulations. The study is aimed to know the implementation of those regulations. It based on purposive sampling and reliable objects. The data are on primary data obtained by interview and questionnaires. The questionnaire is based on compliance check on stated regulations with additional information, likert scale, and essay format. The sample was taken from some sources (see a table below).

Table 1. Sample Observation Number of Islamic Cooperatives in Depok

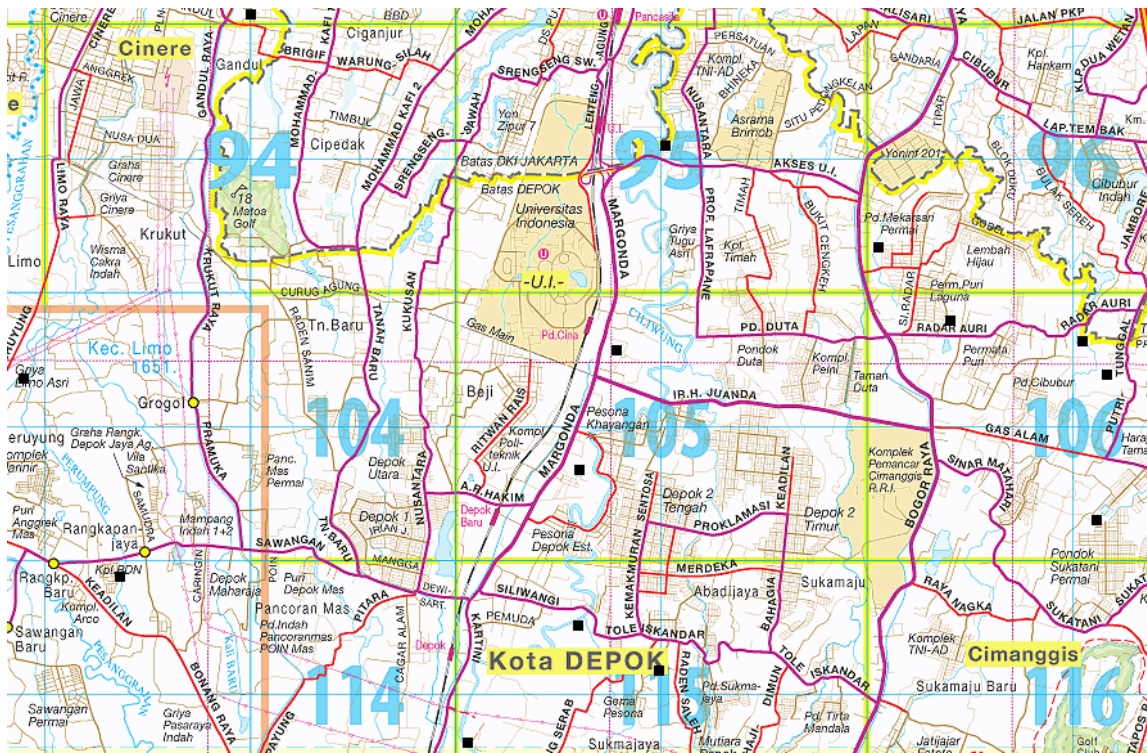
No	Item	Number
1	Data from Dhuha Nusantara (.xls) dan www.smecca.com	10
2	Data from PUSKOPSYAH	24
	Total	34
	Less filtered by PUSKOPSYAH -Depok	-22
	Total	12
3	Data from internet searching	3
4	Data from Ministry of Cooperatives and Small Medium Enterprises 2008 (ranking)	2
5	Data from www.diskumkm.jabarprov.go.id	2
	Total	19
	Reduced 1 as incomplete	-1
	Total sample	18
	Field observation: Closed or inactive	-3
	Field observation: Converted to under bank-partner	-1
	Final observed sample	14

Source: Stated above

The questionnaire was given directly to the 14 samples from 14 to 19 April 2010. It is different from bank, Islamic cooperatives open on Saturday, from 8 a.m. until 1 p.m. It is an effective way because banks are officially closed, so they can operate optimally as people cannot go to banks on that day. Data collection process was done from 23 until 28 April 2010. The depth interviews were conducted during the collection of questionnaire. There were 13

questionnaires filled, but some were incomplete. From the 13 questionnaires, it was indicated that 8 Islamic cooperatives were initially established on the basis of residential complex and multi-businesses group. This actually benefited as it had captive market.

Figure 2. The Map of Sample Object



■ = Islamic Cooperative

Some Evaluations and Comments

The descriptive statistics describes sample data of Islamic cooperatives. It covers minimum, maximum, average as well as the standard deviation of the number of members, management, employee and clients. Financial data shows the performance of the Islamic cooperatives such as capital, revenue and asset. They are based on the 2009 fiscal year. As some Islamic cooperatives did not fill the questionnaires well, this caused some incomplete data.

The number of Islamic cooperative employees ranges from three to eleven, relatively similar to the management (from 1 to 12). On the other hand, on average there are 419 clients, ranging from 150 to 800. The asset is from Rp 230 million up to Rp 4.0 billion; with the average of Rp 1.4 million (see Table 1).

Table 1. Sample of Descriptive Statistics

	N	Minimum	Maximum	Mean	Std.	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
MEMBER	10	20.00	728.00	198.7000	288.1385	1.390	.687	.251	1.334
MANAGEME	11	1.00	12.00	4.2727	3.0689	1.614	.661	3.763	1.279
EMPLOYEE	13	3.00	11.00	6.3077	2.6263	.877	.616	-.396	1.191
CLIEN	7	150.00	800.00	419.2857	257.0977	.904	.794	-1.002	1.587
CAPITAL	13	30000000	1.8E+09	3.5E+08	5.0E+08	2.558	.616	6.866	1.191
REVENUE	10	50270000	4.8E+09	1.2E+09	1.4E+09	2.374	.687	6.304	1.334
ASSET	12	2.3E+08	4.0E+09	1.4E+09	1.2E+09	1.308	.637	.688	1.232
Valid N (listwise)	3								

Source: Sample data

Some Islamic cooperatives received revolving funds from the government. They received from Rp 50 to 200 millions in 2007. This was not on annual basis. However, these funds did not suffice to boost their activities while they had to pay them in installments basis. The procedure to get the revolving funds were not clear, and only eight out twelve Islamic cooperatives received these funds. Only three from eight Islamic cooperatives stated that the fund is sufficient enough for them. On the other hand, Islamic cooperatives experienced difficulties adding up their funds as they cannot directly absorb funds from society as they are not bank-like institutions. Therefore, they usually utilize funds from Islamic banks which have high margin.

In fact, Islamic cooperatives have a limitation to disburse funds to clients because for prudent concerns (usually only Rp 20 million on average). In special cases, they can disburse bigger fund with stricter requirements. They prefer to disburse to their clients if they have potential and feasible projects or proposals, yet they were not bankable ones. In this case, Islamic cooperatives can approve and grant such activities. In addition, there are informal individual ‘banks,’ mobile banks (Bank Keliling–Bankel) which offer loans easily with high interest. Surprisingly, they are easily found in Depok. To mitigate individual risks, Islamic cooperatives, create good networking one to another to blacklist their clients who deal with the ‘bankel’ or who involve in legally unaccepted actions.

Currently, a number of well-established banks and foreign financing institutions under the Ministry of Finance license can open their branch in the rural areas and small villages near traditional markets. This phenomenon does not benefit Islamic cooperatives. The government should regulate this to create a fair and just competition.

Based on Ministerial Regulation Nr. 06/PER/M.KUKMI/I/2007 on technical guideline of financing program for cooperatives and micro businesses in Islamic schemes (P3KUM), it requires an independent audit to evaluate Islamic cooperatives. So far only four from eight Islamic cooperatives conduct this. At the same time, it is equal in numbers between the revolving fund receiver and others (see table 2). The issue of accountability and regulatory check can be a concern here. There are particular reasons for Islamic cooperatives not to receive revolving funds. They include: (a) management decision for not taking the funds and (b) unclear procedure to get the funds. Since they rely to a large extent on the funds to boost their operations, by which, the funds in immediate need to be increased.

Table 2. Crosstabs between Funds and Audit

			DBS		Total
			.00	1.00	
AUDIT	.00	Count	4	4	8
		% within AUDIT	50.0%	50.0%	100.0%
	1.00	Count		4	4
		% within AUDIT		100.0%	100.0%
Total	Count	4	8	12	
	% within AUDIT	33.3%	66.7%	100.0%	

Source: Sample data

Table 3 shows the compliance on Ministerial Regulation Nr. 32/PER/M.KUKMI/I/2007 on standard operational guideline for cooperative management. The lowest score is on termination procedure (0.5), followed by liquidation procedure (F=0.58) and advanced payment procedure (TIGAG=0.66). The highest is on accounting standard, and all Islamic cooperatives have this standard. This may be caused in average all Islamic cooperatives already have similar software.

Table 3. Descriptive Statistics for Ministerial Regulation Compliance

	N	Mean	Std. Deviation
A	12	.9167	.2887
B	11	.9091	.3015
C	12	.8333	.3892
D	12	.9167	.2887
E	12	.7500	.4523
F	12	.5833	.5149
G	12	.5000	.5222
DUAA	12	.8333	.3892
DUAB	12	.8333	.3892
DUAC	12	.8333	.3892
TIGAA	12	.8333	.3892
TIGAB	12	.8333	.3892
TIGAC	12	.8333	.3892
TIGAD	12	.7500	.4523
TIGAE	12	.8333	.3892
TIGAF	12	.9167	.2887
TIGAG	12	.6667	.4924
TIGAH	11	.7273	.4671
TIGAI	12	1.0000	.0000
Valid N (listwise)	10		

Source: Sample data

Description: A=Organization and management, B=Managing organization, C= Human resources, D= Profit sharing, E=Fund management, F=Termination, G= Liquidation, DUAA=Service coverage, DUAB=Fund raising, DUAC=Disbursement, TIGAA=Management limitation, TIGAB= Fund Balancing, TIGAC= Excess Fund Utility, TIGAD= External fund raising, TIGAE=Cash flow, TIGAF= Petty cash, TIGAG=Advanced payment, TIGAH=Auditing and TIGAI= Accounting

Table 4 shows the preference test on scoring for monitoring guideline on Islamic cooperative (Ministerial Regulation Nr.39/PER/M.KUKMI/I/2007). This conducted by looking from their perception on each scoring parameter. The lowest score is on capital adequacy (PA=57), followed by asset quality of Islamic cooperative (PE=61.5). The highest score is on compliance with Islamic principles (PH=73).

Table 4. Descriptive Statistics of Scoring Performance

	N	Mean	Std. Deviation
PA	10	57.0000	24.5176
PB	10	61.5000	20.0069
PC	10	62.7000	17.7204
PD	10	66.5000	16.3384
PE	10	64.5000	18.9224
PF	10	68.5000	20.8233
PG	10	64.0000	14.2984
PH	10	73.0000	16.3639
Valid N (listwise)	10		

Source: Sample data

Description: PA=Capital, PB=Asset quality, PC=Management, PD=Efficiency, PE=Liquidity, PF=Profile, PG=Growth and Independence, PH=Islamic compliance

As it is required by the Ministerial Regulation, Islamic cooperatives must report to the government on monthly, quarterly and yearly basis. So far, on a yearly basis they report them on time, while for monthly and quarterly basis, the report is not that punctual.

Table 5. Descriptive Statistics for Reporting

	N	Mean	Std. Deviation
MONTH	10	.9000	.3162
QUARTER	10	.8000	.4216
YEAR	10	1.0000	.0000
Valid N (listwise)	10		

Source: Sample data

From respondents' opinions, there are some suggestions for Islamic cooperatives in order to be able to compete in the market:

- a. Islamic cooperatives must be as aggressive as moveable banks and professional like modern banks. This may be applied for Islamic cooperative based on public membership type. As the captive market is not available, then they have to compete with competitors in their surroundings. In addition, Islamic cooperative may face limitation in fund raising due to membership cooperative type. It differs from a bank that can attract huge funds without becoming their depositors as member like a cooperative.

- b. Islamic cooperatives must be supported by all elements of society in the form of participation in funding. It is usually located to specified organization, region, and company. All member should be part of Islamic cooperative in term of deposit or loans, and use other provided services and products for the consumption
- c. Islamic cooperatives need support from the government in terms of capital lending and training. The revolving fund should be given in competitive basis and strictly monitoring. So it can be really revolved to other Islamic cooperative
- d. Islamic cooperatives should have similar tax treatment to the bank for reserves. Similar treatment should be also given to Islamic cooperatives like other financial institutions. This also applied to non-under central bank supervision, however it needs quite strong efforts from the government to cater this issue.
- e. Islamic cooperatives require capable and honest human resources to manage them efficiently. As it still in small capacity, the internal control may not so tight if compared to bank. To solve this, it needs certified manager for Islamic cooperative. In fact, not all Islamic cooperative comply with this regulation.
- f. There must be regulations to maintain the captive market of Islamic cooperatives because well-established banks and other financing institutions can penetrate to local and rural society. The remarkable growth of foreign multi function loans could threat the existence of small or traditional financing institution such as Islamic Cooperative. This also occurs for big bank that permitted to open their branch in rural and suburb region which should be the area of smaller financial institution.
- g. Networking of Islamic Cooperatives. Department of Cooperative and Small Medium Enterprise should coordinate with central bank to have negative clients. So far, Islamic Cooperatives only rely on their networking in located area. However, this effort is quite effective to prevent fraud.

Conclusions

There are some conclusions for this paper:

- d. There is no relevant and reliable database for Islamic cooperatives. Therefore, the government should provide database in order to monitor and access them efficiently. This would benefit for Islamic Cooperative for their reporting and accountability issues. In addition, the society and the cooperative members can actively access information, then participate in Islamic cooperatives
- e. Most Islamic cooperatives still suffer from lack of good human resources. This may be caused by under economics of scale to generate income which caused low compensation system. The optimization or increasing in the capital by the members themselves, actually can be a necessary condition for Islamic cooperatives to be efficient and to meet the economics of scale in business
- f. Most Islamic cooperatives have complied with the Ministerial Regulations. This shows the compliance rate or scoring of Islamic cooperatives to the regulations.
- g. To compete in the competitive business, Islamic cooperatives highly need supporting regulations from the government. For example, the area limitation of commercial banks or financing institutions to operate in a rural area or villages, especially the traditional market areas. This is to create a fair market competition. Others are similar taxation treatment, easy access in funding and the human resource training.

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