

**Financing the Poor: Towards an Islamic Micro-Finance
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**Islamic Microfinance in Indonesia:
The Challenge of Institutional Diversity, Regulation and Supervision**

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Abstract

Islamic finance evolved in Indonesia since 1990 and is now recognized as part of a dual banking system. Lacking broad popular demand, experience differs by sub-sector. Only commercial banks have successfully acquired the art of Islamic banking by training young and dynamic people; yet, they lack experience in micro-finance. Islamic rural banks, mostly under absentee ownership, have failed to prove themselves as efficient and dynamic providers of micro-finance services. Unsupervised Islamic, like conventional, cooperatives are an outright menace to their members, who risk losing their savings. There are two options of promoting Islamic microfinance: (1) assisting Islamic commercial banks to establish units with Islamic micro-finance products, or (2) reassessing in a participatory process the challenges and realistic opportunities of Islamic rural banks and cooperatives, with a focus on effective internal control, external supervision, and the establishment of associations with apex services to their member institutions.

1. Origins and evolution of Islamic finance in Indonesia¹

Indonesia is probably the country with the greatest diversity of both conventional and Islamic microfinance, the former evolving over a period of over one hundred years, preceded by a history of informal finance of unknown depth, the latter, still on a modest scale, over a period of fifteen years. Indonesia possesses one of the most differentiated microfinance infrastructures in the developing world, comprising some 6,000 formal and 48,000 semiformal registered microfinance units serving about 45 million depositors and 32 million borrowers; 800,000 channeling groups; and millions of informal financial institutions and self-help groups. There is hardly an institutional type of microfinance that is not found in Indonesia. One of the most successful microfinance models worldwide, the reformed village units of Bank Rakyat Indonesia (BRI), were designed by the Harvard Institute for International Development in the early 1980s. (*Annex I*)

Islamic finance in Indonesia, the largest Muslim country, has evolved since around 1990, mainly in response to political demands from Muslim scholars and organizations. The first Islamic cooperatives were established in 1990, followed by rural banks in 1991 and the first Islamic commercial bank in 1992. In 1998, Bank Indonesia gave official recognition, as part of a new banking act, to the existence of a dual banking system, conventional and Islamic, or shari'a-based. This led to the establishment of a second Islamic commercial bank (ICB) and, until December 2003, of eight Islamic commercial banking units (ISBU) (out of a total of 138 commercial banks, comprising a total of 299 banking offices), with a continuing upward trend, reaching 3 ICBs and 22 ICBUs², as of December 2006³. The growth pattern of Islamic rural banks has been quite different. After an initial period of

¹ Based on field research in Indonesia between 24 May and 5 June 2004, supported by GTZ. For a full report see Working Paper 2006-2, www.uni-koeln.de/ew-fak/aef.

² This includes BRI Syariah Bank, with 17 branch offices, a subsidiary of BRI expected to become as a separate bank in September 2007. To date there are no BRI village units offering Islamic financial products.

³ For the update until 2006 I am grateful to Dr. Michael Hamp, Bank Indonesia/GTZ Jakarta.

growth until 1996 when they reached a total of 71, their number almost stagnated during and after the financial crisis, reaching 78 by 1998 and a mere 84 by 2003 (out of a total of 2134 rural banks); as of December 2006, their number reached 105. The first Islamic cooperative was established in 1990. Rapid expansion started after 1996, as a result of promotion by PINBUK, and continued throughout the financial crisis, but stagnated after 1999 at around 3000 and declined to less than 2,900 as of 2003 (out of a total of some 40,000 financial cooperatives).

Table 1: Growth of Islamic banking, 1991-2006

Type of Islamic bank	1991	1992	1999	2000	2001	2002	2003	2004	2005	2006
Commercial banks (CB)	0	1	2	2	2	2	2	3	3	3
CB units	0	0	1	3	3	6	8	15	19	22
Total CB offices	0	1	40	62	96	127	299	401	504	636
Rural banks	4	9	78	78	81	83	84	86	92	105
Total number of banks	4	10	81	83	86	91	94	104	114	130
Total number of offices	4	10	118	140	177	210	383	487	596	741

Highlights of the **evolution of Islamic finance** include (Dec. 2003):

- Origins due to initiatives by Muslim scholars around 1990
- Recognition of a dual, conventional and Islamic, banking system by BI in 1998
- *Islamic commercial banks*: continuing upward trend since 1992; 2 Islamic banks and 8 Islamic banking units out of 138 commercial banks
- *Islamic microbanks (BPR)*: Initial growth since 1991 until 1996 followed by stagnation; 84 out of a total of 2134 rural banks
- *Islamic cooperatives*: Start in 1990, rapid expansion after 1996, stagnation in 1999, followed by decline; 2900 Islamic financial cooperatives out of 40,000.

(Annex 2)

2. Islamic commercial banks

The market leaders in Islamic finance in Indonesia are the commercial banks. During the reporting period, 1991-2003, they focused on medium- and large-scale finance. We are now observing the beginnings of a slow expansion into microfinance. Since Bank Indonesia gave official recognition in 1998 to a dual banking system, conventional and Islamic, interest in Islamic meso- and macro-finance has spread among commercial banks, inspired by religious concerns and fuelled by low rates of non-performing loans. Islamic commercial banks, as of 2003, accounted for a mere 0.74% of total assets of the banking sector. However, during 2001-2003 the share of Islamic commercial banks has increased from 0.17% to 0.74% and stood at 2.19% in Dec 2005.

Table 2: Islamic vs. conventional commercial banks, Dec. 2003

	Islamic	Conventional	Total
Date of origin of first bank	1992	1895	
Total number of banks/banking units	10	136	138 + 8 units
Total number of banking offices	255	7,475	7,730
Including BRI units:		11,524	11,779
Total banking assets	0.74%	99.36%	100.0%
Total loans outstanding	1.16%	88.84%	100.0%
Total deposits	0.64%	99.36%	100.0%
Loans-to-deposits ratio (LDR, FDR)	97%	53%	54%
Improvement in NPLR 2000-2003	13.0% to 2.3%	26.8% to 8.2%	26.8% to 8.2%
Return on assets	0.65%	2.1%	2.1%

Most remarkable is the difference in performance between conventional and Islamic commercial banks. In relative terms, (i) the Islamic banks lend more of the funds deposited, with a LDR/FDR of 97% compared to 54% of the total commercial banking sector; (ii) their gross non-performing loans (NPL) ratio is persistently lower, and the improvement of their performance is faster than that of conventional banks after the financial crisis. Non-performing

loans amount to 2.3% of financings outstanding, which is far below the 8.2% of the total commercial banking sector. NPL ratios fell as follows:

- Conventional banks: from 26.8% in 2000 to 14.1% in 2001 and 8.2% in 2003;
- Islamic banks: from 13.0% in 2000 to 4.0% in 2001 and 2.3% in 2003.

Yet, despite the Islamic banks' better performance in terms of portfolio quality, their return on average assets of 0.65% is less than a third of that of the total commercial banking sector at 2.12%. This difference is partially attributed to the rapid increase in the number of Islamic banking units, which have only recently started to lend.

However, note should be taken that the establishment of Islamic banks in Indonesia was not preceded by a broad popular demand for shari'a-based services. This situation appears to have changed little. According to surveys carried out around 2000 in provinces with an average Muslim population of 97%, only 11% were found to understand products and benefits of shari'a banking. Bank Indonesia (2002:10) thus concluded that,

“There is still a gap between needs and knowledge of shari'a financial products and services. The gap could delay the success to mobilise potential public fund to investment because of low switching rate from potential demand to real demand. Furthermore, the gap will also make marketing and selling effort for shari'a banking products and services more difficult.”

3. Islamic micro-banks/rural banks (BPRS)

During the 15-year period 1989-2003, the total BPR sector had grown to 2134, comprising 2050 conventional BPR and 84 BPRS. After a promising start in the early 1990s, the development of Islamic micro-banks has almost come to a standstill. During the six-year period, 1991-96, when their number had reached 71, the BPRS grew at an overall average of 12 per year. During the two years when the Asian financial crisis hit Indonesia, 1997 and 1998, their growth slowed down to less than four per year. During the following five years, 1999-2003, their net growth almost stagnated, averaging one per year: seven were newly established, two were closed at the beginning of 2004. Their total number was 84 in December 2003 (down to 82 in February 2004).

Despite the fact that they had only two years less than conventional BPR, they have attained a mere 4% of the number and 1.5% of the assets of the rural banking sector. The average growth rate of the conventional BPR during the 15-year period was 137 institutions per year – compared to only 6.5 BPRS p.a. during a 13-year period. Conventional rural banks have thus grown more than twenty times faster than Islamic rural banks per year. Moreover, average assets of BPRS amount to only 38% of the assets of conventional BPR; during 2001-2003, total assets of the BPRS grew (nominally) by 70%, compared to a growth rate of 173% of the total BPR sector.

Table 3: Islamic (BPRS) vs. conventional rural banks (BPR), Dec. 2003

	<i>Islamic</i>	<i>Conventional</i>	<i>Total</i>
Date of origin of first rural bank	1991	1989	
Total number of rural banks as of Dec. 2003	84	2050	2134
<i>Percent of BPR sector</i>	4%	96%	100%
Of these newly established:	83	1283	1365
<i>Percent:</i>	6%	94%	100%
Av. number of rural banks p.a. since origin	6.5	136.7	
Total rural banking assets	1.5%	98.5%	100%
Size of BPRS in % of average BPR	38%		
Asset growth during 2000-2003	70%	175%	173%
Total loans outstanding	1.5%	98.5%	100.0%
Total deposits	1.2%	98.8%	100.0%
Loans-to-deposits ratio (LDR, FDR)	126%	103%	103%
Total outreach:			
Rural banking sector	1.5%	98.5%	100.0%
Microfinance sector	0.14%	99.86%	100.0%

There are several reasons for the poor performance of Islamic micro-banks in Indonesia:

- Governance and management problems: many have been established by absentee owners for moral reasons, with an emphasis on social banking, and are managed by retired conventional bankers, who lack dynamism and Islamic banking expertise – with dire consequences on performance
- Inadequate internal control (by absentee commissioners) and a lack of external auditing (due to small size below the limit where auditing is required)
- Lack of popular demand for Islamic banking services
- Emphasis on the informal sector, to the neglect of more profitable market segments
- Lack of mastery of overly complex Islamic banking practices.

(Annex 3)

4. Islamic financial cooperatives

The development of Islamic banking has been paralleled by that of Islamic financial cooperatives (BMT, BTM, Baitul Qirad in Aceh), which evolved in several stages as shown in the table below. The first Islamic cooperative was established in 1990. After 1995 PINBUK, an NGO, started promoting Islamic cooperatives. There were big jumps in numbers during the crisis years 1997/98, followed by a slowing-down, stagnation and decline.

Table 4: The evolution of Islamic cooperatives

No.	Phase	Period	Number of BMT
1	Initial growth	1990-1995	300
2	Rapid growth promoted by PINBUK	1996 1997 6/1998	700 1501 2470
3	Slowing-down of growth	2000	2,938
4	Stagnation and decline	2001 2003	3,037 2,856

Islamic financial cooperatives suffer from the same regulatory and supervisory neglect as the rest of the sector. There is not much difference between Islamic and conventional cooperatives. At most one-fifth of Islamic cooperatives are in reasonably good health. The majority are dormant or non-performing; most of the remaining ones exist for the purpose of receiving funds from the government. The Ministry of Cooperatives does not register cooperatives as Islamic or conventional and provides no information on, or special assistance to, Islamic cooperatives.

Table 5: Islamic vs. conventional cooperatives

	Islamic	Conventional	Total
Total number of financial cooperatives	2900	37,627	40,527
<i>Percent of fin.</i>	7.2%	92.8%	100.0%
Total assets	n.a.	n.a.	n.a.
Total loans outstanding	1.1%	98.9%	100.0%
Total deposits	2.9%	97.1	100.0%
Loans-to-deposits ratio (LDR, FDR)	90%	34%	35%
Non-performing loans ratio (NPLR)	n.a.	n.a.	n.a.
Return on assets	n.a.	n.a.	n.a.
Total outreach: credit accounts	0.7%	99.3%	100.0

In sum, the outreach of Islamic cooperatives is negligible, their overall performance poor:

- There is a lack of regulation, supervision and reliable reporting
- The large majority of Islamic cooperatives is dormant or technically bankrupt
- Their outreach is negligible, accounting for 7.2% of all financial cooperatives, but less than 1% of borrower outreach of the sector

- Their loan portfolio (much of it overdue) accounts for 1,1% of the financial cooperative sector and 0.19% of the microfinance sector
- The savings of the depositors are at great risk.
- Overall there is little difference in performance between conventional and Islamic cooperatives, the latter having inherited most of their problems from the former.
- No remedy is in sight, except in the framework of a total overhaul of the cooperative system, which in fact is now under discussion
- Fresh money pumped into the sector by donor or government agencies without effective regulation and supervision will further aggravate their downfall, as has been historically the case of the state-supported cooperative sector.

5. Islamic financial products

Islamic financial products are complicated, unfamiliar to most, and poorly understood by many banking staff. Most of the lending is trade financing at a fixed margin (*murabaha*), which is felt to be little different from conventional banking, except that it requires two contracts by the bank: one with the seller and one with the borrower to whom the bank sells the commodity. Some statistical details are given in *Annex 5*.

The strength of Islamic finance lies in its conservative character: only real transactions with sufficient collateral, but no speculative investments, are financed. This however has substantially reduced financings to start-ups and micro-entrepreneurs without collateral; a a major section of a potential microfinance market.

Table 6: Financial products of Islamic banks (commercial and rural), in percent, 2000 and 2005

	2000	2005
<i>Financings:</i>		
Musyarakah	2.6	12.5
Mudarabah	30.5	20.5
Murabahah	62.6	62.3
Istishna	6.0	1.8
Qardh	0.0	0.8
Other	0.8	2.1
Total financings in %	100.0	100.0
Amount in million Rupiah	1,239,423	15,231,942
<i>Deposits:</i>		
Wadiah	21.5	13.1
Mudarabah Savings	32.7	28.0
Mudarabah fixed deposits	45.8	58.8
Total deposits in %	100.0	100.0
Amount in million Rupiah	1,028,923	15,582,329
Financing-to-Deposit Ratio, %	123.5	97.8

6. Islamic microfinance in Aceh, a special area⁴

Nanggroe Aceh Darussalam (NAD) is a province with a special status in Indonesia. It has been given autonomy in choosing its own legal framework (*Qanun*) and has introduced Islamic law. In the context of massive international aid after the tsunami and earthquake and a lasting peace accord after 29 years of secessionist unrest, various Indonesian and international agencies, in close cooperation with the reconstruction agency BRR and Bank Indonesia, are now focusing on the reconstruction and reform of the micro-banking and cooperative sectors in Aceh.

⁴ Based on various consultancy reports by H D Seibel to GTZ, 2005 and 2006.

In micro-banking, the emphasis is on restructuring existing privately owned and local government-owned rural banks. In the cooperative sector, a new approach to reform is being taken through Islamic cooperatives and Islamic cooperative rural banks, with a strong emphasis on self-reliance and effective supervision. Of 1,052 government-directed financial cooperatives in the province, registered but not effectively regulated nor supervised, only 3% were found to be performing reasonably well, while 64% were non-performing. In this situation, instead of attempting to reform an ailing conventional cooperative sector, it has been decided to establish new savings and credit cooperatives and to be strict on the legally required minimum share capital as proof of effective ownership. To prevent the failures of the past, GTZ, together with local authorities, PNM and other donors, has adopted a comprehensive financial systems approach:

- a) In an Islamic province given autonomy in choosing its own legal framework and in direct response to popular demand, it was decided to set up *Baitul Qirad*, بيت الإقراض, (BQ), a uniquely Acehnese term for Islamic financial cooperatives;
- b) simultaneously, a support structure of secondary cooperatives (*BQ Centers*) for effective regulation and supervision of the adherence of the primary cooperatives to cooperative law, Islamic principles and internal by-laws is being established;
- c) Islamic cooperative rural banks (BPRS) will be established for liquidity exchange, refinancing and larger financings;
- d) the establishment of an independent financial authority for cooperative supervision, as well as the establishment of a microfinance apex bank, are under discussion.

Islamic cooperative banking software and packages of staff training are provided by PNM. GTZ's support is focused on 15 BQs and two BQ Center at the east coast (in addition to support to privately owned rural banks), serving as a model for expansion over a province with four million inhabitants, and perhaps in other provinces. There is a vast potential for expansion!

7. Assessment

Islamic microfinance, lacking broad popular demand and Islamic banking expertise, so far has been more a political than an economic project in Indonesia. Experience differs substantially by sub-sector:

- (1) Only commercial banks appear to be able of quickly acquiring the art of Islamic banking by training young and dynamic people; but most of the commercial banks lack experience in microfinance as a specialized field.
- (2) Islamic, unlike conventional, rural banks, have failed to prove themselves as efficient and dynamic providers of microfinance services.
- (3) Unsupervised Islamic, like conventional, cooperatives are an outright menace to their member-shareholders and depositors, who risk losing their money.

No information on recent developments in an increasingly differentiated Islamic microfinance sector during the last three years (except in Aceh) is available. On the basis of the existing experience with Islamic finance in Indonesia, decision-makers in favour of promoting Islamic financial services are now confronted with two major options, which are not necessarily alternatives:

- Focusing on Islamic commercial banks in Indonesia and assisting them to establish branches and units with Islamic microfinance products, following the lead of BRI;
- re-assessing in a participatory process the challenges and realistic opportunities of Islamic rural banks and cooperatives, with a focus on effective internal control, external supervision, delegated or auxiliary, and the establishment of associations of respective micro-banks and cooperatives with apex services to their member institutions.

8. Recommendations

We recommend to decision-makers in Islamic organizations, government agencies and donor organizations to cautiously examine the following opportunities for the development of a healthy Islamic financial sector in Indonesia:

- (1) **Commercial banks**, in setting up branch networks of Islamic MFIs, may learn, with good prospects, from the rich experience of successful microfinance strategies and institutions within Indonesia, particularly the BRI Micro-banking Division, one of the most successful microfinance programs in the developing world, which has recently started to set up Islamic units.
- (2) **Islamic rural banks** need to be revamped if they are to play a more than marginal role in Indonesia. This will require an overall development plan for the BPRS sector mutually agreed upon by all stakeholders and a strong banking association to provide a full range of support services to their members. Some of the more successful Islamic rural banks may serve as exposure training sites to future managers. Auditing should be mandatory regardless of size.
- (3) **Islamic cooperatives** suffer from much the same set of problems as the whole cooperative sector. There is little chance for any intervention to be successful in the short run, except in limited areas (such as Aceh). They need a system of prudential regulation, mandatory auditing, and effective supervision by an appropriate financial authority, which is definitely not the Ministry of Cooperatives & SMEs. They should be fully financed through equity and savings deposits of members; only healthy and well-supervised cooperatives should be permitted to collect deposits from non-members. They need strong associations and federations to provide a full range of support services to their members.
- (4) **Permodalan Nasional Madani (PNM)** is a government-owned corporation (TÜV-certified) with independent management, carved out of the central bank after the financial crisis of 1997/98, with the mandate of restructuring and strengthening rural banks and cooperatives serving micro and small enterprises, and a strong focus on Islamic microfinance. It has recapitalized a number of Islamic rural banks and cooperatives; it has also provided Islamic banking software and training to them. PNM is now facing the challenge of fully commercializing its services with national outreach, after the government withdrew its regular budgetary allocations and turned PNM into a profit-making company relying on its own resources. Given its central bank origin, it may be instrumental in promoting mandatory auditing and setting up a financial authority for cooperative supervision. PNM needs financial and institutional strengthening.
- (5) **In the reconstruction of tsunami-stricken Aceh**, a pilot project of establishing a properly supervised system of Islamic cooperatives, to be backed up by Islamic cooperative rural banks, is being carried out. Donor support will expire in 2009, the official end of the reconstruction period. The reconstruction agency BRR estimates that there is a potential for up to 1000 Baitul Quirad in 335 sub-districts. Support is needed for (i) a self-sustaining structure of continued inputs beyond 2009; (ii) expansion over all sub-districts with economic potential; (iii) action research in support of the process of building a comprehensive and sustainable Islamic cooperative sector in Aceh as a prime example of decentralizing regulation and supervision of non-bank microfinance institutions.
- (6) **Comparative studies** are proposed of conventional and Islamic microfinance systems in selected geographical areas (e.g., West Java, Lombok), with particular emphasis on the regulatory and supervisory framework; as well as in-depth case studies of selected Islamic microfinance institutions within a microfinance system context of a given geographical area to serve as benchmarks. This may also include a case study of Islamic microfinance units recently established by BRI, as part of the BRI unit system designed by HIID in 1983.

Annex 1: Institutional variety in Indonesian microfinance: an overview

Indonesia is probably the country with the greatest diversity of both conventional and Islamic microfinance, the former evolving over a period of over one hundred years, preceded by a history of informal finance of unknown depth, the latter, still on a modest scale, over a period of fifteen years. Indonesia possesses one of the most differentiated microfinance infrastructures in the developing world, comprising some 6,000 formal and 48,000 semiformal registered microfinance units serving about 45 million depositors and 32 million borrowers; 800,000 channeling groups and millions of unreported informal financial institutions of indigenous origin. There is hardly an institutional type of microfinance that is not found in Indonesia, though there are wide regional disparities in diversity, depth and outreach, with Java and Bali at one extreme and the outer islands at the other. There is also great variety in institutional performance. Since 1998 there has been a new surge of special initiatives, among them poverty lending programs with weak enforcement of loan repayment.

In Indonesia, Islamic microfinance is an emerging concept. The term microfinance is used in Indonesia in a wider and in a narrower sense. In this paper the term microfinance is used, unless otherwise indicated, in a wider sense, referring, on principle, to small as well as large financial institutions that provide small-size financial services to the lower segments of the rural, periurban and urban population as well as larger-size financial services to successful micro and small enterprises or households. In this sense the term covers an immense variety of microfinance institutions (or: *institutions providing microfinance services*), including indigenous self-help groups (SHGs) functioning as financial intermediaries (*arisan, julo-julo...*), new types of SHGs established by governmental and nongovernmental organizations in large numbers, SHGs linked to commercial and rural banks, SHGs upgraded to semiformal or formal institutions, private deposit collectors and their self-organized associations, member-owned institutions, community- or subdistrict-owned local financial institutions, savings & credit cooperatives, NGOs, regulated microbanks, national and provincial development banks, national and regional or provincial commercial banks with their local units. Such institutions may be owned by private shareholders, members with same or differing voting rights, communities, local or national government, and non-governmental organizations. Both, commercial banks and regulated micro-banks (*Bank Perkreditan Rakyat, BPR*, referred to in English as rural banks or people's credit banks), may be under private, government or cooperative ownership; some microbanks are de facto (not de jure) owned by NGOs. Depending on the applicable regulatory framework, financial institutions may belong to the formal, semiformal or informal financial sector; in Indonesia the latter two sectors also include institutions with financial services in kind (e.g., *rice banks*). All these types of institutions and ownership exist in Indonesia as part of the conventional financial sector.

In a narrower sense, the term microfinance is applied in Indonesia to a large number of mostly semiformal small local financial institutions, which also include associations of informal SHGs, awaiting the passing of the draft microfinance law of 2001. This was formulated under the auspices of the central bank. Since authority over small financial institutions (*Lembaga Keuangan Mikro, LKM*) was passed to the Ministry of Finance, no further action has been taken. There is no information how many of these adhere to Islamic principles.

To-date only a limited number of these various types of financial institutions have generated known Islamic variants. Official statistics exist for Islamic commercial and micro-banks; in official statistics of limited reliability exist for Islamic financial cooperatives. There are no data on other types of Islamic financial institutions. As the emergence of Islamic finance has been an evolutionary process over a period of just 15 years, it is likely that the landscape of Islamic finance will be increasingly differentiated – hopefully guided by past experience. Some of the lessons (to be) learned will be presented in this paper.

Overall Indonesia has acted as a **microfinance laboratory** of both conventional and Islamic financial institutions, demonstrating:

- (1) the scope for institutional variety;
- (2) the importance and the success of regulating and effectively supervising conventional and Islamic micro-banking in the hands of two types of regulated institutions: commercial banks (among them Bank Rakyat Indonesia with its 4000 microfinance units) and rural micro-banks (BPR);
- (3) the failure of effectively supervising vast networks of financial cooperatives and village funds/banks (BKD), most of them non-performing;
- (4) the need of, and demand-from-below for, regulating and supervising small MFIs;

- (5) the opportunities and future challenges of decentralizing regulation and supervision of non-bank microfinance institutions.

During the past two decades, in an increasingly liberal policy environment, two types of regulated microfinance institutions under central bank supervision have gained prominence on the microfinance market: (i) the units of the Micro-banking Division of BRI (the former agricultural development bank, until recently government-owned), reformed as of 1984 with TA from HIID; (ii) rural banks (BPR), since 1988. In 2003, they accounted for 95% of recorded deposits and 75% of loans outstanding of recorded formal and semiformal MFIs. *Financial cooperatives*, about 40,000 in number, account for another 5% of deposits and 18% of loans; they have suffered, rather than benefited, from preferential government treatment and a general disregard for regulation and supervision. There has been no follow-up on the draft microfinance (LKM) law of 2001 for small local financial institutions.

Surplus liquidity and liquidity shortage are two core problems of the financial sector in Indonesia. Surplus liquidity has been a major problem of the commercial banking sector in Indonesia. As of November 2003, banks mobilized Rp 875.4tr (US\$103bn) in deposits, but lent only Rp 475.7tr (\$56bn), generating Rp 400tr (\$47bn) in excess liquidity. Indonesia's problem is how to lend, not lack of funds. The loan-to-deposit ratio (LDR) has been improving in recent years: from 26.2% in 1999 to 43.7% in 2003, but is still low. This problem also applies to the major rural and peri-urban microfinance provider, the BRI Micro-banking Division. Since 1990, the BRI units have produced large amounts of excess liquidity from rural savings, consistently exceeding \$1bn per year throughout and after the Asian Financial Crisis; as of December 2003, its LDR was 47.6%, close to the commercial banking average. There is thus little, if any, justification for donors to pour hard-currency liquidity into the national soft-currency intermediation circuit.

Table 1: Liquidity surplus or deficit in US\$ and loan-to-deposit ratios (LDR) of commercial banks and small financial institutions in Indonesia (BRI units 2003, others ~2000)

Type of institution	Deposits	Loans outstanding	Liquidity surplus*	LDR
Commercial banks	103bn	56bn	47bn	44%
BRI units	3.5bn	1.7bn	1.8bn	48%
Rural banks	923.6m	947.5m	(23.9m)	103%
NBFI	25.1m	54.1m	(29.0m)	215%
Financial coops	172.5m	497.7m	(325.2m)	189%

* (Liquidity deficit)

Source: App. 1 Table 1

A shortage of liquidity has been the problem of most small financial institutions, quite in contrast to commercial banks. Rural banks (BPR), the largest entities among the small financial institutions, with consolidated deposits of Rp 8.89tr and loans outstanding of Rp 9.12tr, had a slight liquidity shortage of Rp 0.23tr and an LDR of 103% as of Dec. 2003. Among the yet smaller non-bank financial institutions, with drastically lower average loan sizes, non-bank financial institutions (NBFI) comprising 4,482 BKD and 1,428 LDKP, with total deposits of Rp 242bn and total loans outstanding of Rp 521bn, had a severe liquidity shortage of Rp 279 bn and an LDR of 215%. Similarly, the 40,527 financial cooperatives, with total consolidated deposits of Rp 1.66tr and loans outstanding of Rp 4.79tr, have a liquidity gap of Rp. 3.13tr and an LDR of 189%. The latter figures conceal major differences between the various types of cooperatives: the private credit unions and the Islamic cooperatives are quite balanced, with LDRs of 109% and 111%, respectively; while the government-pampered USP and KSP have ratios of 314% and 469%, respectively. (Data ~2000) Two major issues and challenges in microfinance have remained:

- how to use the existing massive excess liquidity in the banking sector to extend financial services to those segments of the rural population without access;
- whether, and how, to extend recognition, depositor protection, regulation and (delegated) supervision to large numbers of small financial institutions.

These issues apply to both conventional and Islamic financial institutions in Indonesia.

Microfinance is no panacea, but has contributed somehow to the reduction of poor from 60% in 1970 to 11.5% in 1996. The financial crisis of 1997/98 interrupted this trend; poverty rates surged, but then fell again below 20%. At the same time, the BRI units emerged strengthened, the rural banking sector restructured from the financial crisis, the latter responding positively to the enforcement of prudential regulation.

Below are some of the **highlights of the financial sector framework for Islamic banking and microfinance** in Indonesia:

(1) *A conducive policy environment for Islamic banking and regulated micro-banking in Indonesia:*

- A long history of banking and microfinance, dating back to 1895
- A highly differentiated rural financial infrastructure
- A deregulated policy and institutional framework since 1983
- Increasingly effective prudential regulation and supervision
- An appropriate commercial and micro-banking legal framework, with options for private, (local) government and cooperative ownership
- Effective supervision of commercial and micro-banks by the central bank, greatly strengthened after the financial crisis of 1997/98
- A legal framework at provincial level for some types of non-bank MFIs
- Favorable regulation central bank for Islamic banks and micro-banks⁵
- Establishment of an Islamic banking directorate in the central bank
- BRI⁶ units, a most successful network of microfinance sub-branches, as benchmark institutions
- Restructuring of the banking sector in response to the Asian financial crisis

⁵ No. 10/1998 on Islamic commercial banks; 6/17/2004 on Islamic rural banks; 7/46/2005 on Islamic banking product standardization; 7/47/2005 on transparency of financial condition.

⁶ Bank Rakyat Indonesia is a previously government-owned agricultural development bank.

Seibel, 2007

- A big emerging market for Islamic finance in the largest Muslim country of the world

(2) Lack of a conducive sectoral framework for Islamic cooperatives:

- Lack of prudential regulation of financial cooperatives
- Lack of effective supervision of financial cooperatives
- Market distortions resulting from access to subsidized sources of finance
- Massive government interference in the past, but some recent relaxation and incipient reform efforts
- Cooperative sector in a generally undiagnosed state of ill-health
- Lack of coordination among organizations supporting Islamic cooperatives.

(3) Core challenges to the overall financial sector:

- How to extend recognition, depositor protection, regulation and (delegated) supervision to large numbers of small financial institutions.
- How to use the existing massive excess liquidity in the banking sector to extend financial services to those segments of the rural population without access.

Annex 2: Institutional and regulatory framework: mainstreaming Islamic banking

Bank Indonesia (2002:16) has provided the following vision & mission of shari'a banking development in Indonesia: "A sound shari'a banking system that is competitive, efficient and compliant with prudential practices, and capable of supporting real economic sector through the implementation of share based financing and trades with real underlying transactions in the spirit of brotherhood and good deeds to promote well-being for all society." **The strategic objectives** of shari'a banking development, according to Bank Indonesia (2002:5), include:

- High level of competitiveness while complying with shari'a principles
- Significant roles in sustaining national economy and public welfare
- Global competitiveness through compliance to international operational standards

As of 1998 (Act. No. 10), Bank Indonesia gave official recognition, as part of the new banking act, to the existence of a **dual banking system, conventional and shari'a-based**. The mainstreaming of Islamic banking was backed by Act No. 23 of 1999 concerning Bank Indonesia, which authorizes the central bank to also conduct its task according to shari'a principles" (see chapter 2.1). Beyond this, the law does not specify any substantively different provisions for Islamic banking. In 1999 Bank Indonesia established a team of shari'a banking, converted in 2001 into a bureau and in 2003 into a directorate, with the objective of monitoring the new segment of the banking sector. At national and institutional levels, Islamic finance is supervised by shari'a supervisory boards (SSB). On the whole, Bank Indonesia (2002:11) states that there is a "lack of efficient institutional structure supporting efficient shari'a banking operations" and suggests to develop the following:

- *Shari'a auditor* to ensure the compliance of shari'a banks with shari'a principles
- *Communication Board (FKPPS)* to enable an effective coordination of the effort to improve public awareness and education for shari'a banking
- *Institution for Shari'a Financing Insurance* to provide financial protection to shari'a banks against fraudulent practices by recommended customers
- *Shari'a Finance Information Center* as a linkage between the real and the shari'a finance sector
- *Special Purpose Company* to facilitate asset securitization for Islamic banks

Annex 3: Islamic micro-banks (BPRS)

The mission of Islamic rural banks in Indonesia is helping the enterprising poor, particularly small traders and micro-entrepreneurs, in contrast to conventional BPR which are oriented to profit-making. Two problems have resulted from the way the BPRS have defined their mission: On the demand side, many of the customers have a (mistaken) concept of low or no interest rates or profit margins in shari'a banking. On the supply side, BPRS focus on the micro-sector instead of starting with more profitable market segments such as salary earners and small entrepreneurs. It is this difference in mission which has significantly slowed the growth of BPRS. While both are (mostly) established by wealthy local people, the owners of BPR have a commercial orientation with the objective of increasing their wealth, while the owners of BPRS have a social mission, combined with the intention to cover their costs.

Ownership: Most BPRS are privately owned, usually by one majority shareholder and several minority shareholders. In some cases, Islamic foundations, companies and local government are shareholders. Some Islamic cooperatives, BMT, have initiated the establishment of a BPRS, but due to lack of capital are not shareholders. Most owners are absentee owners, living in Jakarta or a provincial capital. If there are many shareholders, their involvement in decision-making is small if not totally lacking. In contrast, many owners of conventional BPR also act as general managers or president-directors.

Board of directors: Every BPRS has three boards: a shari'a board which watches over Islamic principles, a management board and a supervisory board. Members of the shari'a board usually come from religious organizations like the local Majlis Ulama, from mass organizations and Islamic universities. The supervisory board of commissioners (*komisaris*) comprises representatives of majority shareholders and financial experts. There are usually three members on the shari'a board and three on the supervisory board. It is rare that anyone of them has a regular full-time or part-time position; most of them act perhaps one day a month or upon request – a significant factor in weak internal control.

Management, upon the insistence of Bank Indonesia as the regulator, is usually comprised of one or two directors with banking experience. Due to the recent history of Islamic banking and an overall shortage of trained bankers, very few BPRS managers have any experience in banking. Most are retirees from conventional banking, who have received some training in Islamic banking principles. This has resulted in a selection of older people frequently from state banks, lacking perhaps in drive and innovativeness as one might expect from younger people eager to experiment with fresh ideas in Islamic banking.

Control and supervision: Internal control is by absentee commissioners whose activities are limited to receiving monthly reports and monthly or quarterly visits: either the commissioners visiting the bank; or the bank visiting the commissioners – sometimes in far-away places. Their role is generally considered not very. External auditing by a public accountant is compulsory if assets exceed Rp 10bn; but most lack dynamic growth and remain below that limit. Supervision of BPRS as part of the banking system is compulsory and carried out by Bank Indonesia on an annual basis. Accounting and reporting standards, including the computation of standard performance ratios, are regulated and enforced by Bank Indonesia.

Market segment: The BPRS market segment covers the enterprising poor with existing enterprises, predominantly small traders. BPRS are open to all, irrespective of their religion.

Islamic banking principles: Outside religious organizations, there seems to be little if any public debate over interest or profit-sharing rates and principles of conventional vs. Islamic banking. Reportedly Islamic banking is mostly a matter of access and effectiveness rather than religious conviction.

Financial products for the poor and non-poor: Under shari'a there are two models of client selection: (i) clients with existing businesses and successful operations for at least two years. (ii) new entrepreneurs without preceding business experience. The vast majority of clients are those with existing business and a good track record; they can be financed through such financial products as Murabahah, Musyarakah and Mudarabah, which involve some form of profit-sharing. New clients without a track record are considered very risky and represent but a small minority; they can be financed through Qard al-Hassan, soft loans without any charge or profit-sharing. Islamic micro-bankers point out that not everyone is a born (micro-) entrepreneur; many of the poor lack the qualification to become entrepreneurs and should rather become workers in larger enterprises, which may in turn be financed through Islamic commercial banks. Consumer loans and loans for speculative investments, which could be ruinous to the borrower, are excluded from the range of permissible purposes of financing.

Deposits : Remuneration of depositors is based on the Mudarabah principle of partnership-based revenue-sharing between depositors and the bank. The ratios varying in the sample BPRS from 30:70 to 50:50. In some banks the revenue-sharing arrangements are negotiable. BPRS are less successful in deposit mobilisation than BPR. The deposit volume of an average BPRS is less than one-third of the sector average (Rp 1.31bn, or US\$ 155,000, compared to Rp 4.17, US\$ 493,000). Among BPRS, deposits amount to 57.4% of total assets, among conventional BPR to 69.1% (BPR sector average: 68.9%). BPRS finance 79.4% of their loans outstanding from deposits, BPR 96.8%. In other terms, the loans-to-deposit ratio (LDR) of BPRS is 1.26, the LDR of BPR is 1.03. We might conclude that revenue-sharing is not as attractive to depositors as a definite interest rate.

Financings (loans): The main loan product in BPRS is Murabahah, i.e., a sales contract between bank and customer with a fixed profit margin for the bank. Flexible profit-sharing, which is cumbersome to calculate, is of minor importance. Qard al-Hasanah, a financial product for the very poor for which the bank bears the full risk but receives no remuneration except an administrative fee of ~1%, exists only in theory. It is listed as one of the products in only one of the BPRS visited, but has no takers. Total financings (loans outstanding) of 84 BPRS as of Dec. 2003 amount to Rp 1.65bn (US\$195,200) per BPRS, compared to Rp. 4.30bn (US\$ 509,000) for the whole BPR sector and RP 4.41bn (US\$ 522,000) per conventional BPR.

Case studies: Two of the five case studies of Islamic micro-banks carried out in 2003, the smallest and the largest, are presented below.

Box 1: Two sample BPRS

BPRS Artha Fisabilillah in Cianjur, the smallest of the five sample BPRS, was established in 1994 by 9 shareholders. By 1997, as a result of lack of management experience, it was technically bankrupt and was restructured. The new management was not very dynamic and was replaced in 2001 by a retired BRI credit officer. The bank, located next to a local market, has 1150 savers and 163 borrowers. With a staff of eleven, six of them loan officers, it offers doorstep collection services to about 200 clients a day. It also offers deposit services to school children and institutions. Total assets are Rp 1.40bn, deposits Rp 0.62bn and financings outstanding Rp 1.21bn. Its overall performance is not yet satisfactory. Its main problem is lack of funds, due to a shortage of deposits and capital from the owners. The bank is struggling with loan recovery and has improved considerably in 2003. Its NPF ratios in 2001, 2002 and 2003 were 9.6%, 190.8% and 4.5%, respectively; its loan loss ratios were 8.9%, 18.7% and 6.25%. Yet the bank has been in the black for the past three years, with ROAs of 2.3%, 1.7% and 2.4% and ROEs of 7%, 4.3% and 8.75%, respectively. Its main future strategy to improve efficiency is staff upgrading through training.

BPRS Wakalumi in Ciputat, the biggest of the five sample BPRS, was established in 1990 by a foundation (Yayasan Wakalumi) as a conventional BPR and converted for religious reasons into a BPRS in 1994. It has 118 shareholders, among them BMI (19%, down from 49%), the former Minister of Cooperatives (23.5%), a Citybank manager (26%), the founding foundation Yaysan Wakalumi (5.6%) and over a hundred individuals, mostly Muslims working at Citybank. The bank seems to have a successful staff promotion strategy: the president director, with a B.A. in agriculture, has been with the bank since 1994, learning on the job and promoted up the ranks; the director, a woman with a diploma in accounting, has been an employee since 1997 and was promoted to director in 2003. The bank has grown rapidly and now has five branches and a staff of 38, 13 among them loan officers. Its 2000 borrowers are mostly small traders on traditional markets, to whom it sells its financings as Islamic products. It has four financing products, with Murabahah the dominant one. Through eight savings products and four term deposit products, it has attracted 5000 savers. With ROAAs in 2001-2003 of 4.1%, 3.65% and 3.35% and ROAEs of 20.3%, 21.05% and 24.1%, respectively, it is highly profitable: apparently a showpiece that could serve as an exposure and apprenticeship training site for other banks.

Annex 4: Islamic cooperatives

Conventional and Islamic cooperatives: Indonesia has a differentiated sector of cooperatives, which has been historically dominated by the heavily subsidized KUD system: *Koperasi Unit Desa*, multi-purpose cooperatives at sub-district level with units at village level. By law all co-operatives had to be integrated into the KUD system. As government intervention in management and resource allocation stifled any spirit of autonomy and self-help, privately organized credit unions and large numbers of self-help groups resisted being incorporated, frequently with official sanctioning. Since the downfall of the Suharto regime, the cooperative sector has seen some liberalization, but is still far from self-organization and autonomy. In fact, the very existence of a Ministry of Cooperatives, with unclear and perhaps counterproductive functions, stands in the way. In the framework of the new decentralization law, cooperatives are now being registered autonomously in the districts and provinces, which is likely to make the task of regulation and supervision more difficult.

According to statistics of the Ministry of Cooperatives, the total number of financial cooperatives (including single-purpose KSP and financial units, USP, of multipurpose cooperatives) amounted to 40,639 as of December 2003, which includes those credit unions and BMT which decided to register as cooperatives; they also include cooperatives which are inactive and have failed to report. The Ministry has financial information on 36,376 KSP/USP as of December 2003.

The KSP and USP are on principle registered with the Ministry of Cooperatives and are subject to a regulatory framework, with minimum capital requirements to become a cooperative, a soundness rating system (based on that for banks) and a loan classification system. However, deficiencies include the absence of legal lending limits, requirements for loan-loss provisioning (left up to individual cooperatives) and sanctions. There is no effective supervision; and whatever regulation exists is not enforced after registration. Also, there is no deposit protection system, and there are no associations of KSP/USP.

In addition there are 1,071 privately organized credit unions (*Koperasi Kredit*) as part of the world credit union movement, WOCCU. They are supervised by INKOPDIT, their national apex, which has rated 90% of them as sound. A small cooperative movement, *Swamitra*, has been organized and effectively supervised by the state cooperative bank, BUKOPIN.

Overview: Islamic cooperatives (BMT)⁷ are a recent development, with rapid growth during the first part of the 1990s. Its 2,938 units (as of 2000) constitute 7.2% of all financial cooperatives, 2.8% of deposits and 1.1% of loans outstanding. Borrower outreach is reported as 73,000 accounts, which is less than 1% of total borrower outreach of the financial cooperative sector. There is no information on the number of deposit accounts. (ADB 2003) The majority of them are registered with PINBUK, not with the Ministry of Cooperatives, which has no information on how many of them are registered as cooperatives. BI estimates the number of registered BMT at 500 out of a total of 3000.

Islamic cooperatives suffer from the same benign regulatory neglect as conventional cooperatives. There is no overall supervision and no systematic recording of either conventional or Islamic cooperatives (BMT); most BMT (83% according to a BI estimate) are not even registered with the Ministry of Cooperatives. After a period of rapid growth after 1995 when PINBUK assumed their promotion, they are now in decline; the majority of the 3000 BMT now are assumed to be dormant or technically bankrupt. PINBUK has no power to enforce reporting, much less so prudential regulation; the Ministry has the power, but does not use it, and may in fact be an inappropriate organization to do so. All general information provided in this report on cooperatives is therefore of questionable validity. In recent years, efforts have been made to improve the quality of cooperatives, reportedly with initial success in some areas like Central Java.

Regional distribution: The majority of the 2900 BMT (60% in 2003) are located on Java, but are spread far more equally over western, central and eastern Java. 20% are on Sumatra, 12% on Sulawesi. BMT are underrepresented on Kalimantan and the smaller islands.

Mission, legal status, governance and supervision: The BMT in our sample see it as their mission to help the enterprising poor, particularly very small micro-entrepreneurs including food vendors. Only an estimated 500 out of

⁷ Mostly referred to as BMT, though there is also a small section of BTM and, in Aceh, of Baitul Qirad.

3000 BMT are registered as financial cooperatives with the Ministry of Cooperatives. It is not expected that the draft microfinance law of 2001, which might have provided a legal framework, will be enacted within the foreseeable future. As cooperatives, BMT are owned by their members; but there is frequently a distinction between shareholding voting and associated members. Board size and composition are not standardized. Only about 50% report to PINBUK, which has no formal supervisory powers; a supervision project was short-lived as funds ran out. INKOPSYAH receives monthly reports from its members as a prerequisite of access to sources of refinancing. Officials from the Ministry of Cooperatives rarely go beyond attending annual meetings when invited. There is no external auditing. Supervisory arrangements, enforcement of standards, information and reporting are either absent or ineffective.

Delivery system, market and outreach: In four BMT visited in 2003, the average number staff is close to four. The average service radius is about 14 km. BMT normally do not have branches. The majority of clients are small and itinerant traders and other micro-entrepreneurs. We estimate total saver and borrower outreach at around 1.7m, but probably only about one-third of them active.

Total assets and sources of funds: The median asset size per BMT is estimated by PINBUK at Rp 250 million (US\$ 24,000) as of 2001. 2% were listed with asset sizes above Rp 1 billion, 9.5% with asset sizes below 50 million. Deposits are the main source of funds, followed by capital. In contrast to conventional cooperatives, borrowings in BMT seem to be of minor importance; the mean loan portfolio is almost matched by deposits (LDR = 103%).

Islamic financial services: The question about differences between Islamic and comparable non-Islamic institutions evoked little response. Deposit products are mainly based on mudarabah, i.e., revenue-sharing between clients and BMT. The average ratio in the four sample BMT for savings accounts is 34:66, average annual returns are 8.8%; the respective values for term deposits are 42:58 and 13.6% - insignificantly higher than in the sample BPRS.

The average number of loan accounts in the four sample BMT, which are far above the national average in size, is 327. Loan sizes are less than half the volume of those in the sample BPRS. In the sample BMT, 61.5% of financings are murabahah, i.e., sales contracts between bank and client – less than in the BPRS. Mudarabah, based on profit-sharing, amount to 32%, and qard al-hassan, a free loan product for poor start-ups, to 3.5%. Requiring collateral is standard. In some cases there are compulsory savings around 5%. Effective annual gross mark-ups, or profit margins to the bank, are around 50%. It is common not to charge penalties on late payments. Given a sample size of 4 out of 2900, these figures are at best indicative.

Economic performance: In the absence of effective regulation and supervision, the performance of BMT is very uneven; information is sporadic. A large number of BMT are dormant. PNM has identified 500 BMT, which are members of INKOPSYAH and registered with the MoC, as worth strengthening; this is less than one-fifth of the total number. In the four sample BMT, NPF ratios vary widely, from 1.4% to 30%, but are mostly estimates. All four BMT in our sample show positive returns on year-end assets, with ROAs ranging from 0.16% to 2.7%; but there may be sizeable bad debts, which are not shown as such.

Affiliations and support: The most important promoter of Islamic cooperatives is *PINBUK*, established in 1995. It provides a MIS to BMT and, through regional offices, basic, intermediate and advanced training, plus training of trainers. *INDOPSYAH*, a commercially operating secondary-level cooperative, functions as a wholesaler of funds from other sources. *Microfin* has established a network of 109 BMT and channels project funds to a total of 673 BMT and KOPONTREN, plus 24 BPRS; it also tries to promote their institutional upgrading to MFIs (LKM) or BPRS. *PNM*, which has replaced BI's (the central bank) liquidity credit operations, has provided liquidity to 85 BMT. To step up its outreach and effectiveness, it will cooperate with *PINBUK* and *ASBISINDO* to provide supervision and training. Additional financial resources are provided by Islamic banks. *BMI*, the first Islamic bank, channels funds through *Baitulmaal Muamalat* and technical assistance through the *Muamalat Institute for Research, Training, Consulting & Publication*. BMTs also receive donations from wealthy Muslims. The main constraints for BMT are management and supervision weaknesses, not funding.

Annex 5: Financial products in Islamic commercial banks, microbanks and cooperatives in Indonesia

Islamic financial products do not seem to have any particular attraction to Islamic financial institutions and their customers in Indonesia. Revenue-sharing in deposits (*Mudarabah*) is unduly complicated and little appreciated because of monthly fluctuations and annual ex-post calculations; remuneration-free *Qard al-Hasanah* deposits, which are very important in Iran, are non-existent in Indonesia. Profit-sharing in lending (*Mudarabah*), which should be the backbone of Islamic banking, constitutes but a small part of the portfolio, as it does in Iran. *Qard al-Hasanah*, remuneration-free lending to the poor, is virtually non-existent in Indonesia. The largest part of the portfolio is trade finance at a fixed margin (*Murabahah*), as is the case in Iran and among the *Sanadiq* (village funds) in Syria. But this again is complicated and increases transaction costs because it involves two contracts by the bank: one with the seller and one with the borrower; simultaneously, it adds information, security and perhaps collateral in the form of the transacted commodity or equipment. Moreover, the art of Islamic banking is not fully mastered by many managers in Islamic institutions, many of them retired conventional bankers. The strength of Islamic finance lies in its conservative character: only real transactions, but no speculative investments, are financed. This reduces financings to micro-entrepreneurs without collateral to a minimum.

Financial products in Islamic commercial banks:

Table 1: Deposits in Islamic commercial banks and banking units, Dec. 2003

<i>Deposits</i>	
Wadiah current accounts	11.1%
Mudarabah savings accounts	28.1%
Mudarabah time deposits	60.7%
Total percent	99.9%
Total amount	Rp 5.72tr
Percent of total liabilities and equity	72.8%

Bank Muamalat Indonesia (BMI), the first and largest Islamic commercial bank in Indonesia, reports the following yields to depositors of 6-7% p.a. on savings accounts and 7-9% on term deposits.

Table 2: Financings by Islamic commercial banks and banking units, Dec. 2003

<i>Financings</i>	
Musharaka financings	5.5%
Mudarabah financings	14.4%
Murabahah receivables	71.5%
Istishna' receivables	5.4%
Other	3.2%
Total percent	100%
Total amount	Rp 5.53tr
Percent of total assets	70.4%

Financings of BMI, with a loan portfolio of Rp. 2.25tr, are distributed product-wise as follows: Murabahah 53.5%; Mudharabah 34.6% Musyarakah 1.6%, other 10.3%.

Table 2A: Financial products of Islamic banks (commercial and rural), in percent, 2000 and 2005

	2000	2005
<i>Financings:</i>		
Musyarakah	2.6	12.5
Mudarabah	30.5	20.5
Murabahah	62.6	62.3
Istishna	6.0	1.8
Qardh	0.0	0.8
Other	0.8	2.1

Total financings in %	100.0	100.0
Amount in million Rupiah	1,239,423	15,231,942
<i>Deposits:</i>		
Wadiah	21.5	13.1
Mudrabah Savings	32.7	28.0
Mudrabah fixed deposits	45.8	58.8
Total deposits in %	100.0	100.0
Amount in million Rupiah	1,028,923	15,582,329
Financing-to-Deposit Ratio, %	123.5	97.8

Financial products in Islamic micro-banks (BPRS)

Table 3: Deposit products in five sample BPRS

BPRS	Total amount (in million Rp)	Number of products	Savings accounts		Time deposits*	
			Revenue-sharing Client-Bank	Average return in % p.a.	Revenue-sharing Client-Bank	Return in % p.a.
1 Alwadi'ah	3,796	4	50:50	6%	70:30	10%
2 Artha Fis.	619	4	30:70	12%	40:60	18%
3 Harum Hik.	4,018	3	40:60	8.8%	65:35	14%
4 Wakalumi	6040	12	35:65	7.09	56:44 to 66:34	11.35 to 13.37
5 Bangka	5,622	n.a.	40:60	7.5%	55:45	11.5%
Mean	4,019	5.75	40:60	8.3%	60:50	13%

Table 4: Loan products in five sample BPRS

BPRS	Amount (in mn Rp)	No. of accounts	No. of products	Loan products in % of portfolio			
				Murabaha h	Musyarakah	Mudrabah	Other
1 Alwadi'ah	5,694.4	800	3	60	40		
2 Artha Fis.	1,208.0	163	4	85			15
3 Harum Hik.	4,312.7	800	1	100			
4 Wakalumi	9,652.8	2000	4	93	5	0.5	1
5 Bangka	4,562.8	n.a.	2	90		10	
Unweighted mean	5,086.1	941	2,8	86	9	2	3

Financial products in Islamic cooperatives

Table 5: Deposit products in four BMT

BMT	Total amount (in million Rp)	Number of products	Savings accounts		Time deposit accounts	
			Revenue-sharing Client-BMT	Average return in % p.a.	Revenue-sharing Client-BMT	Return in % p.a.
At-Taqwa	1,957.9	5	35:65 40:60	9.0 9.6	45:55	13.2

Ibaadurrahman	199.3	4	25:75	5	35:65 40:60 45:55	~12
Latanza	137.15	4	40:60	11	40:60	14-16%
Wira Mandiri	575.8	5		10		14
<i>Mean</i>	<i>717.5</i>	<i>4.5</i>	<i>34:66</i>	<i>8.8</i>	<i>42:58</i>	<i>13.6</i>

Table 6: Loan products in four BMT

<i>BMT</i>	<i>Amount (in mn Rp)</i>	<i>No. of accounts</i>	<i>No. of products</i>	<i>Loan products in % of portfolio</i>			
				<i>Murabaha h</i>	<i>Mudaraba hh</i>	<i>Qard Hassan</i>	<i>Al- Other</i>
At-Taqwa	1,819.4	500	4	70	15	6	10
Ibaadurrahman	217.2	300	2	51	44	2	3
Latanza	345.8	200	2	33	61	6	
Wira Mandiri	587.3	308	4	92	8		0
Unweighted mean	742.4	327	3	61.5	32	3.5	3

Table 7: Financing terms and conditions of BMT At-Taqwa

	<i>Loan products</i>			
	<i>1: Murabaha</i>	<i>2: Mudarabahh</i>	<i>3: Qard Al- Hassan</i>	<i>4: Qard</i>
Portfolio	70%	15%	5%	10%
Number of borrowers	80%	4%	6%	10%
Minimum loan size in Rp million	1	5	0.1	0.5
Maximum loan size in Rp million	25	25	1	2
Profit-sharing margins:				
Nominal (flat)	18-24%	18-24	0	0
Fees if any	1.5%	1.5	0	0
Effective p.a. (approx.)	38-50%	38-50%	0%	0%
Profit-sharing vs. interest rates	A fair system			
Admin. fee for late payment	0	0	0	0
Minimum loan period in months	3	12	3	3
Maximum loan period in months	36	24	12	12
Instalment schedule	M	M	M	M
Collateral/guarantee requirements	Yes	Yes	No	No
Loan size tied to savings?	10%	No	5-10%	5-10%