

Constructing the Supervision Model in Sharia Cooperative Entities

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Abstract—The purpose of this study is to formulate model of supervisory system for sharia cooperative entities. This supervisory system can detect early signs of business failure preventing greater impact for the. This study used qualitative method with descriptive-exploratory approach. The object of the research was the Department of Cooperatives and MSMEs of the Special Region of Yogyakarta. The informants were chief supervisors, Heads of Supervisory Bureau and supervisory staffs at the Department of Cooperatives and MSMEs, members and staffs of shariah cooperative, entities under the supervision of the public institution. The data collection methods were a series of interviews and analysis of shariah cooperative entities financial report as well as relevant rules and regulations. The findings showed five indicators of failing shariah cooperative entities, they are: 1. disruption of liquidity funds to fulfill obligations to the members, 2. Illogical profit sharing, 3. long-term investment that disrupts cash flow, 4. bad financing, and 5. non-compliance towards SOP resulting in fraud.

Keywords: shariah cooperative entities, supervisory model, business failure, liquidity funds, profit sharing

I. INTRODUCTION

In order to enhance development of Sharia cooperatives, the Ministry of Cooperatives and MSME issued the 2004 Decree of the Minister of Cooperatives and MSME number 91 on Technical Guideline for Implementation of Sharia Financial Services as legal standard for *Baitul Maal Wat Tamwil* (BMT), a Sharia organization that works in both social (*maal*) and commercial (*tamwil*) sectors. Furthermore, after the establishment of the 2011 Decree number 21 on Financial Services Authority and the 2013 Decree number 1 on Micro-scale Financial Institution, the Ministry of Cooperatives and MSME through the 2015 Decree of the Minister of Cooperatives and MSME number 16 changed the naming system for Sharia Cooperative/ Financial Service Unit (*Koperasi Jasa Keuangan Syariah/Unit Jasa Keuangan Syariah Koperasi/ KJKS/UJKS Koperasi*) into Sharia Saving and Loan Cooperative/ Sharia Saving and Loan Financial Service Units (*Koperasi Simpan Pinjam dan Pembiayaan Syariah/Unit Simpan Pinjam dan Pembiayaan Syariah Koperasi/ KSPPS/USPPS Koperasi*). However, the public is familiar with the term *BMT* or Sharia cooperatives rather than *KJKS/ UJKS Koperasi* or *KSPPS/ USPPS Koperasi*.

The government supports BMT in order to develop MSMEs that can hardly keep up with large investors. The government has significant role in developing BMT and is required to establish an effective strategy to grow economic condition of the public, including low and middle income individuals (Kirkpatrick & Maimbo, 2002). BMT through Sharia Micro Financial Institutions provides access to capital for low-income individuals. BMT plays strategic role in developing economic condition of low and middle income individuals resulting in sufficient supervision and monitoring from the government (Hoxhaj, 2010), particularly for responsible for large amount of funds, a lot of customers, and business expansion.

BMT and BPRS, running their business based on the Sharia law, are the pioneers of the growth of Sharia Micro-scale Financial Institution (*Lembaga Keuangan Mikro Syariah/ LKMS*) in Indonesia. Several BMTs have shown their spectacular achievement in terms of assets, turnover, and number of branches established. Assets, turnover and branches the BMTs have exceed that average BPRS has. Many BMTs keep growing and have transformed into a reputable LKMS, but many others failed and left negative impression towards economic condition of their members or Sharia financial institution image.

The data obtained from the Ministry of Cooperatives and MSME stated that until May, 2019, there are 123,259 cooperatives in Indonesia, but only 26.59% are active (Departemen Koperasi dan UMKM, 2019). The percentage highlighted poor management from those responsible for the cooperatives and poor supervisory towards the cooperatives; **effective management** is the key for financial institutions to succeed (Peni & Vähämaa, 2012). Such condition shows immediate need for analysis on factors leading to failure in BMT management as well as on effective supervisory and monitoring system for BMT.

A. Statements of Problem

Based on the background, the statements of problem are:

1. What causes failing BMT?
2. What supervisory and monitoring system the Department of Cooperatives and MSME should conduct to create a suitable Supervision and Monitoring for BMT?

B. Objectives

Based on the statements of problem, objectives of the study are:

1. Explore factors contributing to failing BMT,
2. Provide recommendation for the Department of Cooperatives and MSME on an effective supervisory and monitoring system for BMT.

C. Significance

Practical significance of the study is to identify factors that cause business failure for BMT, and analyze an quick and effective supervisory and monitoring system for BMT. Quick refers to short amount of time the system needs for anticipating bigger risk, while effective refers to match between the system and issues each BMT encountered. The major significance of the study is recommendation for the Department of Cooperatives and MSME in conducting supervision and monitoring towards in a quick and accurate manner.

II. LITERATURE REVIEW

The Decree of Minister of Cooperatives and MSME number 91/Kep/M.KUKM/IX/2004 on Technical Guide and Implementation of Sharia Financial Services Unit/ Cooperative stated that objective of Sharia cooperative (Koperasi Jasa Keuangan Sharia/ KJKS) is to economic empowerment, particularly MSMEs based on th Sharia laws. The purpose explicitly puts Sharia cooperative in strategic position in an attempt to increase public welfare, more particularly low and middle income individuals or the majority of Indonesian people (Bintoro & Soekarto, 2013; Kementrian_Koperasi_dan_UKM, 2004).

Referring to the Decree, Sharia cooperatives, especially those using Baitul Maal Wat Tamwil or BMT as a part of their names, has grown rapidly. Low and middle-income society are more familiar with BMT compared to Sharia banks (Zerai & Rani, 2012). It encourages growth of BMT particularly providing funding for the public.

Even though BMT grows rapidly in Indonesia, the government has yet to establish a clear regulation on BMT (Masyithoh, 2016). It will affect management of BMT itself (Hoxhaj, 2010; Seibel, 2008). Financial institution depends heavily upon good management system (Kirkpatrick & Maimbo, 2002), and good management system requires supervision and monitoring from regulator (Jalbert, Rhodes, Flygare, & Kane, 2010), in this case the Department of Cooperatives and MSME.

Zubair (2016), Sa'Roni (2010) dan Hosen and Sa'roni (2012) conducting studies on successful management system for BMT showed that several BMTs have established a solid management system and achieved long-term success. Different from the three previous studies, objectives of the study are to explore factors that cause business failure for BMT and develop an effective

supervisory and monitoring system for BMT preventing bankruptcy and minimizing financial loss occurring after bankruptcy.

III. METHODOLOGY

A. Type and Framework of the Study

The study used qualitative method with descriptive-explorative approach. Field observation was designed to identify some factors causing business failure in BMT and construct supervisory and monitoring model based on early warning system. Focus of the study was parameter used to identify business failure in BMT and develop effective Supervisory and Monitoring model for BMT. Based on the exploration, the researchers formulated a Supervisory and Monitoring model for BMT that matched MSME and Sharia Cooperative development strategies.

B. Object and Informants

The object of the study was the Department of Cooperatives and MSME of Yogyakarta and BMT UMY. In line with the objectives of the study, the study explored information from the regulations related to BMT and information from relevant informants. The informants were chief supervisors, Head of Bureau of Supervisory, and and staffs of Bureau of Supervisory at the Department Office of Cooperatives and MSME, members and staffs of shariah cooperative under the supervision of the public institution, and members of BMT.

The data analysis consisted of two stages; the first was to identify some factors that cause failing BMT, and the second was construct a Supervisory and Monitoring model for BMT that provided early warning sign for the Department of Cooperatives and MSME.

C. Data and Sources of Data

The data consisted of primary and secondary data. The primary data were obtained based on interviews while the secondary data were obtained from documentation and analysis towards the Legal Basis, Structure of Organization, Financial Reports, and the regulations and legislatives on BMT and Sharia cooperatives.

D. Data Collection and Data Analysis

The data were obtained based on interviews towards the informants, observations towards operating activities of the BMT, and documentation (financial and non-financial information). The interviews were structured, semi-structured and open-ended. The interviews were recorded using an audio recorder, and then transcribed into digital form (Creswell, 2013). The data were analyzed in order to see their relevance towards the objectives of the study and grouped based on the statements of problem. The data analysis approach was deductive, thematic analysis, method of analysis for analyzing qualitative data which consisted identification, analysis and reporting based on objective of study.

Thematic analysis itself is one of the classifications of content analysis. Results of the interview and observations would result in conclusion on factors causing failing BMT. Reliability and validity test was conducted with the following procedures: a) rechecking the transcription, and b) peer de-briefing (Creswell, 2013). The procedure conducted after the validity and reliability test was triangulation in order to strengthen validity of the data (Denzin & Lincoln, 2009).

IV. FINDINGS AND DISCUSSIONS

Based on the data obtained from the informants, namely the Head and staffs of Bureau of Supervisory of the Department of Cooperatives and MSME, as well as manager, operating manager, and staffs of the BMT, five factors that cause business failure for BMT are 1) BMT failure for providing funding for its members, 2) illogical profit sharing for its members, 3) long-term investment that causes cashflow disruption, 4) bad financing, and 5) non-compliance towards SOP that results in fraud. The following section provides explanation of the five factors.

A. *BMT Failure in Providing Funding for its Members*

Main factor indicating business failure in BMT is its failure in providing funding for its members. The cause was that BMT did not have enough liquidity to provide funding for its customers or to even fund its operating activities. Managers of the BMT stated liquidity is the main indicator of failing BMT. Customer trust will decline sharply once BMT is unable to provide funding for its members. As the result, the members will withdraw their saving reducing amount of liquidity BMT has.

BMT will suffer from worsening financial issues when it does not get funding from its members but has to spend money for operating activities and provide funding for the members. In the long run, BMT can no longer run its business and has to declare bankruptcy.

B. *Illogical Profit Sharing for its Members*

Return of Investment is the major factor that encourages BMT members to make investment. Therefore, investors or the members are attracted to large profit sharing. Nevertheless, the Department of Cooperatives and MSME staffs and BMT managers warned BMT members about too much and illogical profit sharing. Too much profit sharing is a sign that BMT management needs large amount of funding to fund their operating activities or an indicator that a BMT is facing financial issues.

Members can invest safely in BMT with healthy financial situation, one that needs funding for its members in the form of credit. One should be careful prior to making investment in BMT that requires funding for its operating activities. The later type of BMT will try to "seduce" its members to invest their funds by large return of investment.

Once BMT solves its financial issues, it will run

normally, but when it is unable to overcome the issue, it may have to declare bankruptcy (business failure).

C. *Long-term Investment Causing Cashflow Disruption*

BMT management should design good planning and risk management prior to investment. Even though BMT has high cashflow, management should make careful calculation before making investment. The consequence of long-term investment is longer return of investment, which will eventually affect amount of cashflow BMT has.

There are times when BMT members make huge investment resulting in a significant increase of cashflow, but some other times BMT may not even have enough liquidity for short-term cashflow. Without careful planning or cashflow analysis, BMT management may be trapped in making long-term investment. Huge investor has always had positive impact towards BMT, however when such investor withdrew his or her investment all at once, BMT may not have enough liquidity for its operational activities. In short, BMT should really understand the risk.

When BMT management makes long-term investment that results in cashflow disruption, BMT may not be able to provide funding for its members and therefore, will no longer gain trust from its members. As the consequence, management should find effective solution for the financial issue in order to prevent the members from withdrawing their fund continuously forcing BMT to declare bankruptcy.

D. *Bad Financing*

BMT management is responsible for managing their assets into productive business or a safe and profitable investment. Each investment will end in either profit or loss. To anticipate negative end of investment, BMT management should establish a good system for internal control system based on the Sharia principles.

According to the BMT management, high-risk investment may result in bad financing. Bad financing will lead to financial loss and cashflow disruption because BMT does not have enough cash from its members anymore. In short, bad financing will cause business failure.

E. *Non-compliance towards Standard Operating Procedures on Providing Fund for BMT Members*

The informants (BMT management) stated that bad financing had negative impact towards liquidity of the BMT. Each BMT should establish a standardized procedure, an internal control system, to avoid bad financing.

As an addition, the informants also stated that bad financing is the result of BMT management's non-compliance towards SOP. There are several loopholes in BMT credit procedures for example feasibility, credibility, guarantee and loan term.

High level of bad financing will result in inability to generate cashflow and failure to provide funding for its members. Then, BMT members will withdraw their money as they lost their trust in BMT. When BMT management cannot overcome this issue, BMT may have to declare bankruptcy.

Based on the informants, BMT management, and the staffs of the Department of Cooperatives and MSME, these five factors are the most contributing factors to business failure in BMT. There are some other contributing factors but these five are the dominant ones. Out of the five, the first factor or failure to generate funding for its members is the primary factor causing business failure in BMT. The other four cause the first one to occur. In other words, liquidity is the start of financial difficulty BMT encountered. Therefore, BMT is responsible for making sure that it has enough asset for its operating activities, including providing loan for its members. When BMT management can anticipate the four later factors before the first one is taking place, it is very likely that BMT is able to run its operating activities normally.

Based on the analysis towards the five factors, the researchers develop an efficient supervisory and monitoring system for BMT as target. The Department of Cooperatives and MSME of Yogyakarta is responsible for implementation of this supervisory and monitoring system.

1. BMT management should make financial report regularly and send the report to the Department of Cooperatives and MSME using web-based application;
2. The public institution analyzes the financial report and classifies BMT into one of the following criteria, namely:
 - a. Very intensive: BMT is facing financial issue (does not have enough liquidity) and cannot gain trust from its members any longer;
 - b. Intensive: BMT is facing financial issue (does not have enough liquidity), yet is able to maintain trust from its members;
 - c. Semi Intensive: The second, third, fourth and fifth factors of failing BMT are identified. BMT is facing financial issues but it can still gain trust from its members;
 - d. Regular. BMT is running normally and none of the five factors of failing BMT is identified.

Web-based application is one requirement to make sure that the supervisory and monitoring model runs smoothly. Such application helps BMT reporting its financial performance and operating activities to the Department of Cooperatives and MSME. The public institution conducts an early supervision and monitoring towards BMT (early warning system) in order to anticipate business failure in BMT.

The informants from the Department of Cooperatives and MSME stated that the institution found it difficult to supervise and monitor the BMTs in Yogyakarta due to:

1. Very few BMT report their financial performance regularly;
2. Monitoring is conducted once a year;
3. Shortage of staffs for financial analysis.

Those conditions above prevent the Department of Cooperatives and MSME of Yogyakarta from getting current information about all BMT in their area. Many times, the public institution obtained information about business failure in BMT from the public or the Police Department. As an addition, an investor, who lost 30 million rupiahs after making investment in a failing BMT, reported that he could not access any information on financial performance of the BMT he had invested in. He was not aware that the BMT was facing financial issue (liquidity issue). He found out that he lost his money after knowing that the BMT where he had saved his money went out of business.

V. CONCLUSION

Objectives of this study are to identify factors that cause business failure in BMT and construct a suitable supervisory system to prevent business failure in BMT. The analysis reveals 5 major indicators of failing BMT, namely:

1. BMT failure for providing funding for its members,
2. Illogical profit sharing for its members,
3. Long-term investment that causes cashflow disruption,
4. Bad financing, and
5. Non-compliance towards SOP that results in fraud

The informants stated that the most influential factor that causes business failure in BMT is the first one or failure to provide funding (credit or capital) for its members, while the remaining factors took place prior to the first one. To answer the second research question, the supervisory and monitoring system to prevent failing BMT is categorized into four scales, namely:

1. Very Intensive
2. Intensive
3. Semi Intensive
4. Regular

These four scales are developed based on risk each BMT has and risk here refers to the 5 factors that influence business failure in BMT.

Contribution of this study is a quick and efficient supervisory and monitoring model for BMT. This model is then implemented using web-based technology connecting BMT and the Department of Cooperatives and MSME so that the public institution can monitor performance and risk of all BMT realtime. The public institution can apply supervisory model for BMT based on risk each BMT has.

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