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ABSTRACT
Islamic microfinance concept is surrounded by Muslim developing countries, which are very interested in the issue and most of all in the relation between Islamic bank and microfinance system with the micro entrepreneurs. This paper aims to focus on the role of Islamic microfinance and its potential to provide financing for the micro entrepreneurs in Muslim societies such as in Indonesia. The objective of the paper is to contribute awareness of Islamic microfinance system by providing an overview of the characteristics and practices of Islamic microfinance system and its institutional networks that are involved in providing financial services to poor segment entrepreneurs in Muslim societies such as Indonesia. In addition, to confirm that Islamic microfinance is the most effective solutions to micro entrepreneurs’ financial needs, focusing on their activities that lack capital but are promising and show potentials, by using the concept of societal institutions within The Network Triangle methodological approach. The possibility of introducing a financing system with the network triangle and societal institutions concept explained that Islamic microfinance could formulate useful contributions to the economic growth and poverty alleviation in the Muslim world especially in Indonesia.

Keyword: network triangle, Islamic microfinance, micro entrepreneurs

1. INTRODUCTION
Islamic microfinance represents the convergence of two rapidly growing industries, microfinance and Islamic finance. Islamic finance as a worldwide phenomenon, which is involving Islamic banking, variety of institutions and instruments, plays important role to the microfinance system especially when it comes to providing financial access for the poor. The paper try to determine various aspects about Islamic microfinance to micro entrepreneurs, and how Islamic banking and microfinance could be the key to provide financial access for millions of poor or micro entrepreneurs especially in Muslim developing countries and societies such as Indonesia.

As the world’s largest population of Muslims, Islamic banks, institutions and instruments in Indonesia are developing rapidly, and have lots of enthusiastic support from many young people and intellectuals. It evidence proved that there are considerable demands for Islamic banks especially in low and middle income predominantly by Muslim societies and many countries where the majority of the populations are constituted by Muslims, who currently reject microfinance products that do not comply with the Islamic law (shari'ah) although in general Islamic microfinance system in these countries is still in its infancy, and business models are just emerging. However, even if the interest is high, there are very few examples of actual operating in the field of Islamic banks involved in microfinance. In fact, only minimum amount of capital assistance available for micro entrepreneurs in Indonesia and most of them generally borrow from moneylenders or private sectors that require them to pay lots of interest. Therefore, the Islamic bank, as a bank without interest, constitutes an example
of how Islamic microfinance represent effective solutions to micro entrepreneurs financial needs, focusing on their activities that lack capital but are promising.

2. METHODOLOGY

This paper uses qualitative methodology to gather an in-depth understanding about networks and societal sector institutions in relation with the financing for micro entrepreneurs by Islamic microfinance system and how its influence in the Muslim world in general and in the context of Indonesian society.

In order to study the issue by using the qualitative methodology, this paper divides into four sections. The first section includes a brief description of Islamic banking and different investment modes used by Islamic banks. Second section includes a brief discussion about microfinance as a contextual review and Islamic microfinance as a different concept. The third section includes a brief description about the concept of networks and societal sector institutions. The last section of the paper includes discussions about various issues of how Islamic microfinance promotes different network relationships and the influence of societal sector institutions in Islamic microfinance. In each sections also includes descriptions within the context of Indonesian society that might provide comparison and certain differences within the general context.

The result of this qualitative study reflects the view of how Islamic banking and microfinance system, if properly implemented, will help in promote and complement the development of micro entrepreneurs in the Muslim world including Indonesia.

3. ANALYSIS

a. Islamic Banking

In the past few decades, Islamic banking and institutions have developed in many countries including the United States and United Kingdom. In certain countries such as Iran, Sudan, and Pakistan, most of their financial intermediaries conform to the principles of Islamic law, as defined by local authorities. In most other countries such as Indonesia, where Muslims constitute the majority of the population, Islamic transactions and institutions make up a small part of the total and must compete with conventional financial institutions. Because of this reason, many involved in Islamic banking, would like to minimize the differences between Islamic and conventional banking. However, the basic principle of Islamic banking is different with the conventional one because all financial transactions dealings with the Islamic banking system have to avoid interest. As interest is prohibited in Islam, Islamic bank cannot be justified or simply converge with the conventional ones.
An Islamic Bank: A Bank Without Interest

An Islamic bank may be defined as a financial intermediary whose objectives and operations as well as principles and practices must conform to the principles of Islamic law; and consequently, is conditioned to operate all its activities without interest (Alam, 2001). The introduction of Islamic banking in modern world is based on the principles of Islamic economics. As observed by Molla et al. (1988), the aim of Islamic economics is not only the elimination of interest-based transactions but also the establishment of just and balanced social order free from all kinds of exploitation.

Scharf (1983) explained that Islamic banks could make a useful contribution to economic growth and development particularly in a situation of recession, stagflation and low-growth level because the core of their operation is oriented towards productive investment. Practical and immediate co-operation possibility exists between Islamic banks and enterprises all over the world. The possibility of introducing an interest-free financing system through Islamic banking principle, Scharf (1983) also argues that the establishment of Islamic financial system based on the principle of shariah is not only feasible but also profitable.

Financial intermediation in Islamic banking between the bank and the client takes place as a partner rather than debtor-creditor relationship as in conventional banks. According to Alam (2000), the financial activities of modern conventional banks are based on relationships between depositors and bank on the one hand and between the borrower and the bank on the other hand. Conventional banks regard interest as the price of credit reflecting the opportunity cost of money. Banking in an Islamic framework could not be based on the debtor-creditor relationships as interest is prohibited in Islam. This principle is applicable to two main factors of production, i.e. labor and capital. According to this principle, as no payment is allowed to labor, unless it is applied to work, no reward for capital should be allowed, unless it is exposed to business risk. From these two principles of the theoretical basis of Islamic banking, it may be said that Islamic financial relationships are of a participatory nature (Ahmad, 1993). Based on the interest-free financing principle, business practices especially sources and uses of bank's fund, there are several different modes of investments used by Islamic banks.

Investment Modes Used By Islamic Banks
Investment modes in Islamic Banking are done in several main ways (Zaher and Hassan, 2001):

1. Mudaraba or capital financing

Mudaraba is a trust based financing agreement whereby an investor (Islamic bank) entrusts capital to an agent (Mudarib) for a project. Profits are based on a pre-arranged and agreed on a ratio. This agreement is akin to the Western style limited partnership, with one party contributing capital while the other runs the business and profit is distributed based on a negotiated percentage of ownership. In case of a loss, the bank earns no return or negative
return on its investment and the agent receives no compensation for his (her) effort”. In this kind of contract, all the financial responsibilities rely on the business itself: the financial institution invests on an idea, a project and shares its fate.

(2). **Musharaka or partnership financing**
This contract is very similar to a joint venture with participation financing. “Two parties provide capital for a project which both may manage. Profits are shared in pre-agreed. The peculiar aspect ratios but losses are borne in proportion to equity participation” of this contract is not the sharing the profit and losses, but sharing the management and the decision making process.

(3). **Murabaha or mark-up (costs-plus profit based financing)**
This constitutes one of the most well known Islamic products, consisting in a cost-plus profit financing transaction in which a tangible asset is purchased by an Islamic institution at the request of its customer from a supplier. The Islamic institution then sells the asset to its customer on a deferred sale basis with a mark-up reflecting the institution’s profit.

(4). **Ijarah (leasing) and Ijara wa-Iqtina (leasing purchase)**
These concepts are very close to the Western idea of leasing. In the first case, the financial institution leases an asset to its customer agreeing on lease payments for a certain period but excluding the option of ownership for the client. In the second case, the client has the option ownership by buying the asset from the financial institution. The conditions governing both types of leasing are that assets must have a long or secure productive life, and must not be handled in an un-Islamic way, meaning that the lease payments must be agreed on in advance to avoid any speculation.

(5). **Bai-Muajjal or cost plus sales under deferred payment**
The Bai-Muajjal mode of investment is as like as Murabaha mode of investment with an exception that the sale under this cost-plus sale modes investment is made on a credit basis rather than cash (Alam, 2002).

(6). **Bai-Salam or advance purchase.**
Under bai-Salam mode of investment the bank purchases industrial and agriculture products in advance from their customers. The main features of this mode are: the price is normally paid with the execution of an arrangement, and according to the terms of agreement the bank receives the goods in due time (Alam, 2002).

(7). **Quard E Hasan or interest free loan given to the needy people.**
The practice of dealing with this sort of investment differs from bank to bank. Quard E Hassan is normally given to needy students, small producers, farmers, entrepreneurs and economically weaker sections of the society, who are not in a position to obtain loan or any financial assistance from any other institutional sources. The main aim of this loan is
to help needy people in a society in order to make them self-sufficient and to raise their income and standards of living (Alam, 2002).

2. Islamic Banking In Indonesia

Indonesia, with the world's largest population of Muslims, has come to Islamic banking as a slow start and lags behind compared to Malaysia and Singapore. The first Islamic cooperatives were established in Indonesia in 1990, followed by rural banks in 1991 and an Islamic commercial bank (ICB) in 1992.

According to Timberg (2004), Islamic banking in Indonesia has some unusual characteristics. Like most microfinance institutions in Indonesia, Islamic institutions, micro or otherwise, are generally private, for-profit institutions based on the intermediation of depositor funds secured on a competitive market. In this they are different from microfinance institutions in almost every other country in the world. They typically have no explicit social goal other than profit maximization and conformity with Islam, though in some cases a social element is present, as we will see. Social impacts are thus the result of the market impacts of the Islamic institutions. Many Islamic institutions in Indonesia, particularly Bait Maal Wat Tamwil (BMT, Islamic financial cooperatives) are located in rural areas and provide agricultural financing. Nonetheless, the focus of Indonesian Islamic financial institutions is typically urban and geared toward the financing of trading operations.

a. Islamic Commercial Banks

The market leaders in Islamic finance in Indonesia are the Islamic commercial banks. During the reporting period, 1991-2003, they focused on medium and large-scale finance. As of 2003, they accounted for a mere 0.74% of total assets of the banking sector. However, during 2001-2003 their share had increased from 0.17% to 0.74% and stood at 2.19% in Dec 2005 (see Table 1). Currently, there are 5 Islamic commercial banks including the Bank Muamalat, which has been functioning since 1992 as the first Islamic commercial bank in Indonesia (see Table 2).

According to Seibel (2007), the growth of Islamic finance in Indonesia is mainly due to an expansion of supply, gladly accepted, rather than broad popular demand. When Bank Indonesia, the central bank, commissioned surveys in provinces with an average Muslim population of 97%, it found that only 11% understood products and benefits of Islamic banking. It concluded that, "There is still a gap between needs and knowledge of Islamic financial products and services. The gap could delay the success to mobilize 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 Islamic banking products and services more difficult.".

1 Bank Indonesia, The Blueprint of Islamic Banking Development in Indonesia, Jakarta 2002, p.10.
Table 1
Growth of Islamic Banking, 1991-2005

<table>
<thead>
<tr>
<th>Type of Islamic bank</th>
<th>1991</th>
<th>1992</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
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<tbody>
<tr>
<td>Commercial banks (CB)</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>CB units</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>3</td>
<td>3</td>
<td>6</td>
<td>8</td>
<td>15</td>
<td>19</td>
</tr>
<tr>
<td>Total CB offices</td>
<td>0</td>
<td>1</td>
<td>40</td>
<td>62</td>
<td>96</td>
<td>127</td>
<td>299</td>
<td>401</td>
<td>504</td>
</tr>
<tr>
<td>Rural banks</td>
<td>4</td>
<td>9</td>
<td>78</td>
<td>78</td>
<td>81</td>
<td>83</td>
<td>84</td>
<td>86</td>
<td>92</td>
</tr>
<tr>
<td>Total number of banks</td>
<td>4</td>
<td>10</td>
<td>81</td>
<td>83</td>
<td>86</td>
<td>91</td>
<td>94</td>
<td>104</td>
<td>114</td>
</tr>
<tr>
<td>Total number of offices</td>
<td>4</td>
<td>10</td>
<td>118</td>
<td>140</td>
<td>177</td>
<td>210</td>
<td>280</td>
<td>487</td>
<td>598</td>
</tr>
</tbody>
</table>

Source: Bank Indonesia

Table 2
Islamic Banking Network, 2005 – Sep 2009

<table>
<thead>
<tr>
<th>Bank Umum Syariah (Islamic Commercial Bank)</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>Mar-08</th>
<th>Jun-08</th>
<th>Sep-08</th>
<th>Dec-08</th>
<th>May-09</th>
<th>Jun-09</th>
<th>Aug-09</th>
<th>Sep-09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jumiah Bank (Number of Banks)</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Jumiah Kantor (Number of Offices)</td>
<td>904</td>
<td>1249</td>
<td>1481</td>
<td>1602</td>
<td>1635</td>
<td>1597</td>
<td>1581</td>
<td>1654</td>
<td>1564</td>
<td>1560</td>
<td>1558</td>
</tr>
<tr>
<td>Bank Syariah (Islamic Business Unit)</td>
<td>10</td>
<td>30</td>
<td>36</td>
<td>38</td>
<td>38</td>
<td>37</td>
<td>36</td>
<td>36</td>
<td>36</td>
<td>36</td>
<td>36</td>
</tr>
<tr>
<td>Jumiah Bank Umum (Number of Conventional)</td>
<td>100</td>
<td>150</td>
<td>150</td>
<td>150</td>
<td>150</td>
<td>150</td>
<td>150</td>
<td>150</td>
<td>150</td>
<td>150</td>
<td>150</td>
</tr>
<tr>
<td>Jumiah Kantor (Number of Offices)</td>
<td>154</td>
<td>173</td>
<td>180</td>
<td>190</td>
<td>207</td>
<td>215</td>
<td>216</td>
<td>241</td>
<td>251</td>
<td>256</td>
<td>254</td>
</tr>
<tr>
<td>Bank Pembangunan Rakyat Syariah (Islamic Rural Bank)</td>
<td>92</td>
<td>105</td>
<td>114</td>
<td>125</td>
<td>126</td>
<td>137</td>
<td>137</td>
<td>137</td>
<td>137</td>
<td>137</td>
<td>137</td>
</tr>
<tr>
<td>Jumiah Bank (Number of Banks)</td>
<td>92</td>
<td>105</td>
<td>114</td>
<td>125</td>
<td>126</td>
<td>137</td>
<td>137</td>
<td>137</td>
<td>137</td>
<td>137</td>
<td>137</td>
</tr>
<tr>
<td>Jumiah Kantor (Number of Offices)</td>
<td>92</td>
<td>105</td>
<td>114</td>
<td>125</td>
<td>126</td>
<td>137</td>
<td>137</td>
<td>137</td>
<td>137</td>
<td>137</td>
<td>137</td>
</tr>
<tr>
<td>Total Kantor (Total Number of Offices)</td>
<td>184</td>
<td>210</td>
<td>228</td>
<td>252</td>
<td>263</td>
<td>304</td>
<td>304</td>
<td>304</td>
<td>304</td>
<td>304</td>
<td>304</td>
</tr>
</tbody>
</table>

Source: Bank Indonesia, Islamic Banking Statistic, September 2009

b. Islamic Rural Banks (Bank Perkreditan Rakyat Syariah)

After a promising start in the early 1990s, the development of Islamic rural banks has almost come to a standstill. During the six-year period, 1991-1996, the BPRS (Bank Perkreditan Rakyat Syariah) 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 (see Table.1). Currently, there are 92 Islamic rural banks in Indonesia (see Table.2).

There are several reasons for the poor performance of Islamic rural banks in Indonesia (Seibel, 2007):

1. 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.

2. Inadequate internal control, mostly by absentee commissioners, and a lack of external auditing, due to small size below the limit where auditing is required.

3. Lack of popular demand for Islamic banking products.

4. Emphasis on the formal sector, to the neglect of more profitable market segments.

5. Lack of mastery of overly complex Islamic banking practices.
c. Islamic Financial Cooperatives

According to Siebel (2007), the development of Islamic banking in Indonesia has been paralleled by that of Islamic financial cooperatives. They evolved in several stages. 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 and 1998, followed by a slowing-down, stagnation and decline. (see Table 3).

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

Source: Seibel, 2007

In sum, the outreach of Islamic cooperatives is negligible, their overall performance poor (Seibel, 2007) because:

- 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.
- Fresh money pumped into the sector without effective regulation and supervision will further aggravate their downfall, as has been historically the case of state supported cooperative sectors.
Table 4
Financing Composition of Islamic Bank and Islamic Business Unit

<table>
<thead>
<tr>
<th>Islamic Bank (customer)</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Al-Akbar Mukarabah (Mudarabah)</td>
<td>7.2%</td>
<td>6.8%</td>
<td>6.7%</td>
<td>6.5%</td>
<td>6.3%</td>
<td>6.1%</td>
<td>5.9%</td>
<td>5.7%</td>
<td>5.5%</td>
<td>5.3%</td>
</tr>
<tr>
<td>Al-Akbar Mqasarabah (Mudharabah)</td>
<td>4.8%</td>
<td>4.6%</td>
<td>4.5%</td>
<td>4.4%</td>
<td>4.3%</td>
<td>4.2%</td>
<td>4.1%</td>
<td>4%</td>
<td>3.9%</td>
<td>3.8%</td>
</tr>
<tr>
<td>Al-Akbar Mukarakabah (Masharaka)</td>
<td>5.5%</td>
<td>5.3%</td>
<td>5.2%</td>
<td>5%</td>
<td>4.8%</td>
<td>4.7%</td>
<td>4.6%</td>
<td>4.5%</td>
<td>4.4%</td>
<td>4.3%</td>
</tr>
<tr>
<td>Al-Akbar Jibalah (Jibalah)</td>
<td>0%</td>
<td>0.1%</td>
<td>0.2%</td>
<td>0.3%</td>
<td>0.4%</td>
<td>0.5%</td>
<td>0.6%</td>
<td>0.7%</td>
<td>0.8%</td>
<td>0.9%</td>
</tr>
<tr>
<td>Al-Akbar Ijtihad (Ijtihad)</td>
<td>2%</td>
<td>2.1%</td>
<td>2.2%</td>
<td>2.3%</td>
<td>2.4%</td>
<td>2.5%</td>
<td>2.6%</td>
<td>2.7%</td>
<td>2.8%</td>
<td>2.9%</td>
</tr>
<tr>
<td>Al-Akbar Gharb (Gharb)</td>
<td>1.5%</td>
<td>1.4%</td>
<td>1.3%</td>
<td>1.2%</td>
<td>1.1%</td>
<td>1%</td>
<td>0.9%</td>
<td>0.8%</td>
<td>0.7%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Al-Akbar Ijtima (Ijtima)</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Total</td>
<td>15.2%</td>
<td>15.3%</td>
<td>15.4%</td>
<td>15.5%</td>
<td>15.6%</td>
<td>15.7%</td>
<td>15.8%</td>
<td>15.9%</td>
<td>16%</td>
<td>16.1%</td>
</tr>
</tbody>
</table>

Source: Bank Indonesia, Islamic Banking Statistic, September 2009

However, the work of the Shariah Bureau of Bank Indonesia demonstrates that Indonesia, especially in particular parts of the country, has considerable unmet demand for Islamic banking. It is illustrated in Table 4 and Table 5 below that the mode of Murabaha is the highest composition of Islamic financing system in Indonesia, followed by Mudharaba and Musharaka. Murabaha as trade financing at a fixed margin, 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. The strength of Islamic banking 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 major section of a potential microfinance market.

Table 5
Financing Composition of Islamic Rural Bank

<table>
<thead>
<tr>
<th>Islamic Rural Bank (customer)</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Al-Akbar Mukarabah (Mudarabah)</td>
<td>7.2%</td>
<td>6.8%</td>
<td>6.7%</td>
<td>6.5%</td>
<td>6.3%</td>
<td>6.1%</td>
<td>5.9%</td>
<td>5.7%</td>
<td>5.5%</td>
<td>5.3%</td>
</tr>
<tr>
<td>Al-Akbar Mqasarabah (Mudharabah)</td>
<td>4.8%</td>
<td>4.6%</td>
<td>4.5%</td>
<td>4.4%</td>
<td>4.3%</td>
<td>4.2%</td>
<td>4.1%</td>
<td>4%</td>
<td>3.9%</td>
<td>3.8%</td>
</tr>
<tr>
<td>Al-Akbar Mukarakabah (Masharaka)</td>
<td>5.5%</td>
<td>5.3%</td>
<td>5.2%</td>
<td>5%</td>
<td>4.8%</td>
<td>4.7%</td>
<td>4.6%</td>
<td>4.5%</td>
<td>4.4%</td>
<td>4.3%</td>
</tr>
<tr>
<td>Al-Akbar Jibalah (Jibalah)</td>
<td>0%</td>
<td>0.1%</td>
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Source: Bank Indonesia, Islamic Banking Statistic, September 2009


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Although Indonesian-banking system has a slow start and lack behind Malaysia, along with Singapore, Bank Indonesia's official still believes that Indonesia could improve its Islamic banking system and will become the largest one in ASEAN regions. As its growth rate in 2009 has increased up to 35.6%, while the global Islamic banking system growth is only about 15% to 20% (Nibra, 2009). The deputy Director of Shariah Division of Bank Indonesia, Mulya E. Sirega, has predicted that away forward, Islamic banking system in Indonesia will be improved. Therefore, there is a need of mapping strategy in order to aim the right target of Islamic bank's market share, by implementing good corporate governance in Islamic banking operation pertaining to human capital and ICT (Nibra, 2009).

Micro Finance

1. Microfinance: A Contextual Review³

Microfinance emerged in the 1970s as social innovators began to offer financial services to the working poor - those who were previously considered “unbankable” because of their lack of collateral. The most common microfinance product is a microcredit loan- usually less than US$ 100. This tiny loans are enough for hardworking micro-entrepreneurs to start or expand small businesses, or buying wholesale products to sell in a market. Income from these businesses provides better food, housing, health care and education for entire families, and most important, additional income provides hope for a better future.

Microfinance institutions (MFIs) exist in many forms, credit unions, commercial banks and most often, non governmental organizations (NGOs). Many microfinance institutions use social collateral in the form of peer groups to ensure loan repayment. Microcredit loan cycles are usually shorter than traditional commercial loans – typically six months to a year with payments plus interest, due weekly. Shorter loan cycles and weekly payments help the borrowers stay current and not become overwhelmed by large payments. The global repayment rate for microcredit loans is higher than 95%, which allows MFIs to re-lend these funds to even more clients. During the past 30 years, microfinance has been proven to be a powerful poverty alleviation tool. It is one of the development tools with the potential to be financially self-sustaining.

Even though the industry has demonstrated that MFIs can self-sustaining business, most still rely on a limited pool of donor dollars. Without access to capital, growth traditionally stops once initial grant money is distributed as microcredit loans. Even after more than 30 years of industry effort, 80 percent of the working poor are still without access to microfinance services. At current growth rates, the gap will not closed for decades. MFIs must access large amounts of capital to expand their operations and provide loans and other financial products to

³ Alam, Mohammed Nurl (2009), Microfinance: An Innovative Solution. Islamic Banking. Networking and Micro Enterprise, papers presented at Post Graduate Studies at IEF, Trisakti University, Jakarta Indonesia, November 22-26, 2009
dramatically more clients. These large amounts of capital are accessible only through the formal capital markets, and currently most MFIs have neither the track record nor the clearly articulated business plan to attract this funding. Thus, for microfinance to achieve its potential as global poverty alleviation tool, the microfinance industry must grow scale.

2. Islamic Microfinance

Islamic microfinance represents the confluence of microfinance and Islamic finance. According to Karim et. al. (2008), Islamic microfinance has the potential to not only respond to unmet demand but also to combine the Islamic social principle of caring for the less fortunate with microfinance’s power to provide financial access to the poor.

Between the most complete researches on the topic, Dhumale and Sapcanin (1999) drafted a technical note in which they tried to analyze how to combine Islamic banking with microfinance. They took into consideration the three main instruments of Islamic finance, mudaraba, musharaka and murabaha, trying to use them as tools to design a successful microfinance program (Segrado, 2005):

a). Mudaraba model: the microfinance program and the microenterprise are partners, with the program investing money and the microentrepreneurs investing in labor. The microentrepreneur is rewarded for his/her work and shares the profit while the program only shares the profit. Of course the model presents a series of difficulties, given most of all by the fact that microentrepreneurs usually do not keep accurate accountability which makes it more difficult to establish the exact share of profit. As stated before the, these models are complicated to understand, manage and handle which implies that those who are involved need specific training on the issues. For this reason, and for an easier management of the profit sharing scheme, the mudaraba model might be more straightforward for businesses with a longer profit cycle.

b). Murabaha model: under such contract, the microfinance program buys goods and resells them to the microenterprises for the cost of the goods plus a markup for administrative costs. The borrower often pays for the goods in equal installments, and the microfinance program owns the goods until the last installment is paid.

c). Musharaka model: a profit sharing joint venture, designed to limit production or commercial activities of long duration. Under this contract, the bank and the microentrepreneurs contribute capital jointly, managerial expertise and other essential services at agreed portions. Profit and losses are shared according to the contract agreed upon. An individual partner does not become liable for the losses caused by others.

Musharaka model is the most favorable finance model for microentrepreneurs. Khalifa & Shazali (1988) carried out a study on the possibility of using musharaka as the financial mode for the Financial Organizations (FOs) in the Islamic Financial System (IFS) in Sudan, they
argues that the musharaka finance model is considerable as an optimum risk management strategy for the small-scale farmers, since it does not require collateral. Musharaka model is used by rural based Small Cottage Industries (SCI) owners in Sudan, in many different fields such as agriculture, industry, trade, manufacturing, marketing, animal production and services (Alam, 2007: p.13).  

3. Microfinance and Islamic Microfinance in Indonesia

a. Microfinance in Indonesia

In Indonesia, microfinance services are implemented by microfinance institutions that can be divided into two categories, i.e., bank and non-bank sectors. BRI (Peoples Bank of Indonesia) and BPR (Rural Bank) belong to bank sector, while non-bank sector can be classified into two kinds: non-formal and formal. Formal category includes cooperative, Lembaga Dana dan Kredit Pedesaan (LDKP/ rural credit financing institution), pawnshop, and Badan Kredit Desa (BKD/ rural credit association). LDKP gets formal status formal Pemda (local government) while BKD is supervised by BRI on behalf of BI (Central Bank of Indonesia). Classified into non-formal category, microfinance institutions are carried out by NGOs and self-help groups (Ismawan and Budiantoro, 2003).

The demand driven for microfinance development is so great, considering that 98.5% business entity in Indonesia or 41.8 million of business units are still in micro category, of which less than 10 million of business units get finance services from formal market. The rest are mostly trapped into informal market called moneylenders. The interest rates charged by moneylenders are so high (ranging from 20%-50% per month). Different from many other countries in which microfinance is developed by NGOs, in Indonesia microfinance development role is hold by government. Unfortunately, the main weakness of government project is that it is not sustainable. Psychologically in encountering such a project, the people consider it as grant so that sometimes it is not repaid. Furthermore, the interest applied is subsidized which results in negative impact or distortion on microfinance (commercialization) industry (Ismawan and Budiantoro, 2003).

Considering various kinds of microfinance in Indonesia, eventually it is often called as microfinance laboratory in the world, and great need of development, a forum to develop microfinance is required. The objective of the forum is to build microfinance as industry to reach the poor widely. For that reason, Gema PKM (The Indonesian Movement for Microfinance Development) as a forum consisting of 7 stakeholders, i.e., government, finance institutions, NGOs, private sector, academicians/ researchers, mass organizations, and funding

4 Alam, Mohammed Nurul (..... p.13), The Islamic Banking System in Different Socio-Cultural Environment Context (A comparative study of Islamic banks in Bangladesh, Turkey, Cyprus and Sudan)
b. Islamic Microfinance in Indonesia

Compare with conventional institutions, the emerging of Islamic microfinance sector in Indonesia, particularly rural banks and financial cooperatives, have insignificant evolves. According to Seibel (2004), Islamic microfinance in Indonesia, lacking broad popular demand and Islamic banking expertise, so far has been more a political than an economic project. Experience differs substantially by sub-sector. 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. This may change with the recent entry of BRI units and some other banks into Islamic banking. Islamic, unlike conventional, rural banks, have failed to prove themselves as efficient and dynamic providers of microfinance services. Unsupervised Islamic, like conventional, cooperatives are an outright menace to their member-shareholders and depositors, who risk losing their money.

As it’s already indicated before in previous section about Islamic banking in Indonesia that the emerging of Islamic microfinance sector compare with the conventional institutions and its prospects to grow is that (Seibel, 2004):

1. Islamic commercial banks, accounts for a mere 0.74% of the total assets of the banking sector during the reporting period 1991-2003 (despite 13 years of existence). However, since Bank Indonesia officially recognized a dual banking system, conventional and Islamic, in 1988, interest in Islamic middle and macro finance has spread among commercial banks, fuelled by low rates of non-performing loans. Over the period 2001-2003 the share of Islamic commercial banks increased from 0.17% to 0.74%. By setting up branch networks of Islamic MFIs, may profitably learn from the rich experience of
successful microfinance strategies and institutions within Indonesia, particularly the Bank
Rakyat Indonesia (BRI) Micro-banking Division, one of the most successful microfinance
programs in the developing world.

(2). **Islamic rural banks** (Bank Perkreditan Rakyat Syariah, BPRS) operate under the same
effective prudential regulation and supervision as commercial banks and conventional rural
banks (BPR). After a promising start in the early 1990s, their development has since
almost come to a standstill. Despite the fact that they have had only two years less than
conventional BPR, they now comprise a mere 4% of the total number of rural banks, and
1.5% of the assets of the rural banking sector. Many investors are absentee owners acting
out of moral commitment, who leave the management to retired commercial bankers who
lack the requisite skills. Islamic rural banks need to be revamped if they are to play more
than a marginal role in Indonesia. This will require an overall development plan for the
BPRS sector to be formulated that has been mutually agreed upon by all stakeholders,
coupled with a strong banking association to provide a full range of support services to its
members. Some of the more successful Islamic rural banks may serve as exposure training
sites for future managers. Auditing should be mandatory regardless of size.

(3). **Islamic financial cooperatives** (Baitul Maal wa Tamwil, BMT) suffer from the same
regulatory and supervisory neglect as the rest of the sector. After a period of rapid growth
during much of the 1990s, they are now in decline, with perhaps no more than one-fifth in
good health. Fresh money pumped into the sector without effective regulation and
supervision will contribute to their downfall, as has been the case in the state-supported
cooperative sector. There is little chance of any intervention being successful in the short
run, except in a limited area. They need a system of prudential regulation, mandatory
auditing and effective supervision by an appropriate financial authority. 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.

On the basis of 13 years of experience with Islamic finance in Indonesia, decision-
makers in favor of promoting Islamic financial services are now confronted with two major
options: (a). Focusing fully on Islamic commercial banks in Indonesia and assisting them to
establish branch networks with Islamic microfinance products. (b). Re-assessing in a
participatory process the challenges and realistic opportunities of Islamic rural banks and
cooperatives, taking into consideration the lack of broad popular demand, be it from poor or
non-poor, and the lack of dynamic growth (Seibel, 2004).
c. Concept of Networks and Societal Sector Institutions

1). Concept of Networks

A common feature in the network approach is the focus on the system of enterprises instead of an enterprise being an independent unit. Here, the enterprise is regarded as a node in a system of commercial and relations, where production is regarded only as a part of the activities of the enterprise (Rasmussen, 1988). As observed by Easton (1989), network is defined as relationships, and positions, structures and processes.

There are several different types of Network:

a). In the field of sociology, Kanter (Rasmussen 1986) has developed three typologies of network:

(1). Instrumental network, which describe relations relations’ e.g. supply and sales contacts, PR relations’ etc.

(2). Personal or (affective) network, where contacts between people are rooted in sympathy as in the case of friends and contacts in "clubs" or mutual support, exchange of information and as a source of mutual inspiration.

(3). Symbolic or (moral) networks, which are rooted in common attitudes towards a specific goal (political, ethnic, religious, moral etc.) that ties the member together (Rasmussen, 1988). These types of network according to Szarka (1990) consist of culturally induced values.

b). In an organization or industrial undertaking, the individual or an organization is taken to be a unit that is responsible for various activities. Network may be classified into two groups; external or interorganizational and internal or intra-organizational networks:

(1). External or interorganizational network. Institutions outside the organization, which greatly influence the overall development of the organizational activities, are normally known as external sources for organizational achievement. A well-established relation with these sources is essential in attaining a higher level of performance in organizational activities. As the actor forms a relationship with the outside source an external or interorganizational relation emerges. Thus an external network means relations of an organizational unit to other organizations. According to Aldrich (1979), "An interorganizational network consists of all organizations linked by a specified type of relations and is constructed by finding the ties between all organizations in a population."

(2). Internal or intra-organizational network is a link or relation that builds among the individual actors within the organization. In an organization activities at different levels are interdependent requiring close ties among the individuals within the organization.

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1 Alam, Mohammed Nurul (2009), Concept of Networks, Islamic Banking, Networking and Micro Enterprise, papers presented at Post Graduate Studies at IEF, Trisakti University, Jakarta Indonesia, November 22-26, 2009
Departmental as well as interdepartmental links within the organization are essential to promote the organizational efficiency and an internal network plays an important role in this respect by providing facilities to grow strong ties among individuals and groups in the organization.

c). Personal Network is a relation between persons that is based on both social and business activities. According to Johannisson & Gustafsson (1984), personal networks are constituted by relationships based on trust and thus established through an elaborate learning process, encompassing both the joint history of the parties involved and their assumed future.

d). Industrial Networks is a relationship that takes place among all actors that are involved in making the industrial functions efficient and effective. Axelsson and Easton (1994) define industrial network in the following words, ‘A network is a model or metaphor, which describes a number, usually a large number, of entities, which are connected. In the case of industrial as opposed to, say, social, communication or electrical networks, the entities are actors involved in the economic processes which convert resources to finished goods and services for consumption by end users whether they be individuals or organization’. As explicated by Johansson & Håkansson (1993, cf. Axelsson & Easton 1994), there are three classes of variables such as actors, activities and resources in industrial networks.

e). Social Network

A social network consists of social tie or relations, which are from and characterized by social norms, based on culture, family, relatives and friends and acquaintances. Social network as it is observed by Anderson & Carlos (1976), ‘rests on the premise that a person’s social conduct, decision, process, orientation and attachment should be viewed in the context of his network relationship’. A Social network can also be defined as a relationship that enables one to collect information about the conduct and behavior of others in society.

The concept of different networks as indicated before is shown in the figure 1 below.

Figure 1

Concept of Networks

- Personal Network
- Industrial Network
- Social Network
- Actors
- Activities
- Resource
- Instrumental Network
- Personal Network
- Symbolic Network
- Interorganizational Network
- Intra-O rganizational
2. Societal Sector*

The concept of the Institutional-Network analytical framework shown in following Figure 2 below, is used to studying differences in Islamic banks within the Islamic Financing Systems in Bangladesh, Turkey, Cyprus and Sudan (Alam, 2002), which is also useful for other countries to study their differences.

Jansson (2002) in his Networks Institutions Model highlighted certain macro institutions such as religion, state, family/clan and country culture. These are specific institutions that influence activities of various actors in the organizational fields. Societal sector institutions are important influencing factors on exchange activities between lenders and borrowers. Like other least developed nations the exchange activities within and between SCIS and MFS are influenced by institutions like country culture, religion, family/clan, political system and the government.

Based on Whitley (1992a, 19992b) and Jansson’s theoretical concepts as mentioned above an Institutional-Network Framework (Alam, 2002) and is used to study the lender-borrower network relationships between different units of the financing system of the MFS field and different units in the different SCI system of the SCIS field as well as the characteristics of these systems.

Units in the organizational field SCIS as shown in the analytical framework above are grouped into different systems, such as the grass-root level SCI system (GL), the season-based SCI system (SB) and the semi mechanized SCI system (SM). Similarly, the financing organizations of similar nature within the MFS field are grouped into different financing systems. These are: the Islamic financing system (IFS), the market based financing system (MBFS), the cooperative financing system (CFS) and the traditional money lending system (TMLS). The IFS includes different Islamic banks (see Figure 3). The MBFS includes private and government owned commercial banks. The CFS includes both private and government cooperative banks and the TMLS include money lenders in rural areas.

Other organizational fields in the second rectangle of the analytical framework include various economic actors in organizational fields such as customers, suppliers, competitors and different intermediaries, with which SCIs and financing organizations in the financial market field interact. These actors in other organizational fields are directly or indirectly related to the lender-borrower network relationship within the financial market fields.

* Alam, Mohammed Nurul (………). The Islamic Banking System in Different Socio-Cultural Environment Context (A comparative study of Islamic banks in Bangladesh, Turkey, Cyprus and Sudan)
3). Islamic Microfinance Network Relationships

a). Islamic Microfinance System Promotes Different Networks

As it's indicated before from the previous section, Islamic microfinance promotes different network relationship such us:

(1). Personal networks are constituted by relationships based on trust. It means personal relationships are deeply rooted in the mutual support, inspiration and help each other. Because in order to obtain the loan from the organization within Islamic microfinance system, the setting of group is normally done with small scale industry owners of the same nature or related to the same units of productions.

(2). Symbolic networks develop as the lending procedures of the Islamic microfinance system develops network relationships between small scale industry owners of similar nature and backgrounds that deeply rooted in the same religious, moral, political or ethnic goals that tie members together.

(3). Social networks establish based on the personal and symbolic relationships close ties, trust and unity among relatives, friends and various social groups intensifying the social networks within the small scale industry system. Thus it is concluded that like other networks, social networks also influence the institutionalization of the new saving habits among the rural-based small scale industry owners.

(4). Intra-organizational network relationships are promoted immediately by the close ties among workers within the organizations.

(5). Inter-organizational network relationships establish since the individual savings are organized and managed through group savings, an individual small scale industry owner develops another relationship with other small scale industry owners. Furthermore, since the entire saving activity and accumulation of required customers' deposits are supervised by the Islamic microfinance system organizations, their external network relationships are extended to different organizational units in the small scale industry system. Thus the small scale industry owners not only extend their network relationships with the lending organizations within the Islamic microfinance system but also with different small scale industry owners within the system. The newly develop saving habit of the small scale industry system owners intensify both intra- and inter organizational network relationships.

Therefore, it is concluded that the new saving habits not only promote lender borrower relationships but also contribute towards the development of trust, loyalty and obedience within the networks. The financing organizations in the Islamic microfinance system through the institutionalization of saving habits not only contribute the mobilizing idle funds of the
micro entrepreneurs units in different micro enterprises system, but also enable making the proper use of their borrowed funds.

b). The Influence of Societal Sector Institutions in Islamic Microfinance

In promoting the network between the lenders and the borrowers relates to the relationship between the Islamic microfinance system and small scale industry system, Alam (2007) describes the network triangle shown in the following figure. This network triangle does not only consist of deeper lender-borrower relationships with different small scale industry system, but also of intense external network relationships with various individuals and social groups in society.

It is known that the process of every individual small scale industry owner in the system of accumulating their personal savings in different groups and depositing the same with the organizations in the Islamic microfinance system intensifies and develops the degree of trustful personal networks. That personal network are constituted by relationships based on trust which means that personal relationships are deeply rooted in the mutual support, inspiration and help to each other.

It is also known that the organizations in the Islamic microfinance system use both formal and informal procedures to collect information regarding small scale industry units in different small scale industry system. The organizations in the Islamic microfinance system must collect information about borrowers from different sources like religious, social and local influential leaders. Thus, the informal procedure makes the Islamic microfinance system familiar to different groups of people in society and promotes various network relationships.

It also stimulates small scale industry owners to increase their network relationships with various individuals and social groups who act as informants to the organizations in the Islamic microfinance system. The extension of the network relations of the small scale industry system to these groups forming a triangle network consisting of the Islamic microfinance system, small scale industry system and the groups of local, social and religious leaders.

c). Islamic Microfinance Networks in Indonesia

Different from Islamic microfinance system in almost every other country, especially Sudan, Bangladesh, Turkey and Cyprus, the informal procedure is not implemented in Indonesia. Islamic microfinance system in Indonesia is still using the formal procedure, same with the conventional ones. Formal means of maintaining lender-borrower relationships and also collecting information about customers is a western practice that is uncommon in developing nations like Indonesia, due to their poor socio-economic infrastructure.

Many Islamic microfinance institutions in Indonesia are still using social collateral to ensure loan repayment. In order to be qualified for loans, the individual customers are not required to make groups and save a certain amount of money and deposit the same with the
organizations in the Islamic microfinance system in. In the lending procedure, before give the lending funds, the financing organizations only relay on the documents and do not need to observe deeply the capacity of the small scale industry units who borrow the funds.

After lending the funds, the financing organizations also do not need to exercise proper supervisions and control on the activities of the borrowers, thus they could not minimizing the financing problems.

Unlike formal, informal ways of collecting information about the small scale industry units, characterizes the Islamic microfinance system, since the information about the small scale industry units is collected from influential local leaders or social and religious leaders. This procedure stimulates small scale industry owners to increase their network relationships with various individuals and social groups who act as informants to the organizations in the Islamic microfinance system.

The financial organizations in a proper Islamic microfinance system also require the individual customer to setting of groups and save certain amount of money to be deposits with the financing organizations. This procedure immediately establish trustful personal networks in the mutual support among group members and develop the symbolic network, which deeply rooted from the same background that tie members together.

In this financing mode, the financing organizations also take initiative to guide customers to develop saving habits and take active part in educating customers to make proper use of the borrowed funds. With their teachings, close monitoring and direct supervisions of borrowers activities, the financing organizations promotes intense relationships with the borrowers. The different financing modes and the distinguished lending policies followed by the organizations in the Islamic financing system assist micro enterprises in different sector of economy in developing the lender-borrower relationships between the exchange partners. Thus, the lending modes in the proper Islamic microfinance system intensify both intra- and inter organizational network relationships. This integrated network relationships will attract many customers especially at rural areas where the micro enterprises in different small scale industry systems are found satisfied with the financing policy of this financing system.

Unfortunately, the intensity of the link between Islamic microfinance system, small scale industry system and the groups of local, social and religious leaders is not well implemented and extended in Islamic microfinance system in Indonesia.

4. CONCLUSION

From the above discussion it is concluded that the Islamic microfinance system in Indonesia is not properly implemented. The microfinance institutions like Islamic banks, Islamic rural banks and Islamic financial cooperatives in Indonesia have failed to prove
themselves as effective and efficient providers of microfinance services. Furthermore, the establishment of institutionalize network relationships between economic actors within the Islamic microfinance system is not establish and extended.

If properly implemented, the Islamic microfinance system will be representing as the effective solutions for micro entrepreneurs needs. Apart from giving credit to customers, organizations within the Islamic microfinance system normally take active part in educating customers regarding newly developed financing procedures and other important aspects in the exchange activities. The organizations in this financing system also take initiatives to guide customers in developing saving habits (Alam, 2002), promoting production activities and in investing funds in different projects. The organizations within the Islamic microfinance system with their teachings to borrowers not only guide them to make proper use of the borrowed funds but also to develop entrepreneurship mentality among them. Therefore, the intense lender-borrower relationships promote the inter-organizational network relationships.

The setting of groups and saving habits also intensifies the trustful personal network relationships that are deeply rooted in the mutual support, inspiration and help to each other. It also ultimately develop the symbolic network among group members that is deeply rooted in religious, moral, political and ethnic goals, which tie the members together. This sort of close contact promotes intra-organizational relationships.

From this perspective it is concluded that if properly implemented, the lending modes of organizations in the Islamic microfinance system intensify both intra- and inter organizational network relationships as an integrated network, which promote effective solutions to complement with the development of micro entrepreneurs in the Muslim world including in Indonesia.

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