

Decoding Success: Investigating the Key Elements that Led to an Islamic Cooperative's Prosperity as a Microfinance Institution

¹Mohammadtahir Cheumar, ²Yusuf Haji-Othman, ³Masri Azrul Nayan, ⁴Mohd Sholeh Sheh Yusuff, ⁵Syed Iradat Abbas, ⁶Norhayati Abdullah, ⁷Ficha Melina, ⁸Marina Zulfa, ⁹Rosida Dwi Ayuningtyas, ¹⁰Patria Yunita

^{1,2,3,4 & 5}Universiti Islam Antarabangsa Sultan Abdul Halim Mu'adzam Shah (UniSHAMS), Malaysia, ⁶Universiti Kuala Lumpur - Malaysian Spanish Institute (UniKL MSI), Malaysia, ^{7&8}Universitas Islam Riau (UIR) Indonesia, ⁹Universitas Wahid Hasyim, Indonesia, ¹⁰Sekolah Tinggi Ekonomi Perbankan Islam Mr. Sjafruddin Prawiranegara, Indonesia.

Corresponding Author Email: tahir@unishams.edu.my

To Link this Article: <http://dx.doi.org/10.6007/IJARBSS/v13-i8/18158> DOI:10.6007/IJARBSS/v13-i8/18158

Published Date: 20 August 2023

Abstract

This article intricately explores the journey of an Islamic cooperative that has transformed into a remarkable microfinance institution, unraveling the threads of its success. Employing a comprehensive investigative approach, this study seeks to uncover the underlying factors driving the cooperative's prosperity in the microfinance sector. Through qualitative research methods, the research meticulously examines the cooperative's regulatory framework, stakeholders' engagement and governance, transparency, and community development initiatives. By illuminating these pivotal components, this study not only enriches the ongoing discourse on the effectiveness of microfinance but also provides invaluable insights for practitioners, policymakers, and researchers working to cultivate sustainable financial inclusion models within Islamic cooperatives and other contexts.

Introduction: Exploring the Success of an Islamic Cooperative as a Microfinance Institution

Microfinance has emerged as a powerful tool in poverty alleviation and economic development, providing financial services to individuals who are excluded from the traditional banking system. While numerous microfinance institutions (MFIs) have been established worldwide, their success varies significantly. One such notable success story is that of an Islamic cooperative functioning as a microfinance institution. This essay aims to investigate the key elements that have led to this cooperative's prosperity and examine how its adherence to Islamic principles has contributed to its achievements (Khaleequzzaman, 2020; Vogel, 2013).

Islamic finance operates on the fundamental principles of Sharia, which prohibits interest-based transactions and promotes ethical practices in financial dealings. Islamic cooperatives adhere strictly to these principles, ensuring that their activities remain compliant with Sharia law. As a result, they have gained recognition for their unique approach to microfinance, offering interest-free loans and promoting social welfare through inclusive financial services. The success of this particular Islamic cooperative can be attributed to several factors (Suzuki & Miah, 2018; Effendi et al., 2018). Firstly, its emphasis on social responsibility ensures that it remains focused on uplifting marginalized communities by providing them with access to capital and resources. By adhering strictly to ethical practices and avoiding exploitative lending practices, this MFI has gained trust within the community it serves. Additionally, the cooperative's strong governance structure plays a crucial role in its success. Transparent decision-making processes, accountability mechanisms, and involvement of members in key decision-making contribute significantly towards building confidence among stakeholders (Khaleeqzaman, 2020; Suzuki & Miah, 2018). Furthermore, this MFI's commitment to financial literacy programs has empowered borrowers with essential knowledge about managing finances effectively. By equipping borrowers with skills necessary for entrepreneurship and encouraging responsible borrowing habits through training sessions and workshops, this cooperative ensures sustainable growth for both individuals and the institution itself. In conclusion, understanding the key elements that have contributed to the success of an Islamic cooperative functioning as a microfinance institution is vital for replicating similar models worldwide (Suzuki & Miah, 2018; Effendi et al., 2018).

Literature Review

Understanding Islamic Finance: Principles and Sharia Compliance in Microcredit Programs

In recent years, Islamic finance has gained significant attention as a viable alternative to conventional financial systems. As microfinance institutions continue to play a crucial role in poverty alleviation and economic development, understanding the principles of Islamic finance becomes essential for ensuring Sharia compliance in microcredit programs (Suzuki & Miah, 2018). Islamic finance is guided by the principles of Sharia, which prohibits usury (riba) and promotes ethical and socially responsible financial practices. It emphasizes risk-sharing, asset-based financing, and the prohibition of investing in prohibited activities such as gambling, alcohol, or pork-related industries (Widiastuti et al., 2022). One key principle of Islamic finance is the concept of profit and loss sharing (PLS). Unlike conventional loans that charge fixed interest rates regardless of business success or failure, Islamic microcredit programs adhere to PLS principles. This means that borrowers share both profits and losses with the institution based on agreed-upon terms. This approach aligns incentives between the institution and borrowers by promoting a more equitable distribution of risk (Khaleeqzaman, 2020). Another important aspect of Sharia compliance in microcredit programs is ensuring that funds are used for halal purposes. Microfinance institutions must ensure that loans are not used for activities prohibited by Islam. This requires careful due diligence to verify borrowers' intentions and monitor their business activities throughout the loan tenure (Suzuki & Miah, 2018; Effendi et al., 2018).

Furthermore, transparency and fairness are paramount in Islamic microcredit programs. Institutions must provide clear information about terms, fees, charges, and repayment schedules to borrowers while avoiding any hidden costs or exploitative practices (Shu, 2023). To achieve Sharia compliance effectively in microcredit programs, it is crucial for institutions to employ qualified scholars well-versed in both Islamic jurisprudence (fiqh) and modern

banking practices. These scholars can provide guidance on structuring contracts within the boundaries set by Sharia while also considering practical aspects related to risk management (Shu, 2023). By adhering to these principles of Islamic finance within microcredit programs, institutions can foster an environment conducive to sustainable economic development while upholding the values of social justice and ethical finance (Suzuki & Miah, 2018).

Investigating the Regulatory Framework for Islamic Cooperatives in Microfinance

The success of Islamic cooperatives as microfinance institutions can be attributed to various key elements. One crucial aspect that needs to be examined is the regulatory framework governing these institutions. The regulatory environment plays a significant role in shaping the operations, practices, and overall success of Islamic cooperatives involved in microfinance (Malim, 2011). Islamic cooperatives operate within a unique financial system that adheres to Sharia principles. As such, it is essential to have a regulatory framework that takes into account the specific requirements and constraints of these institutions. This framework must ensure compliance with Sharia principles while also promoting financial stability and customer protection (Rahmawati & Rinaldi, 2021). In investigating the regulatory framework for Islamic cooperatives in microfinance, several aspects need to be considered. Firstly, it is crucial to examine how these institutions are licensed and supervised by regulatory authorities. This includes understanding the criteria for obtaining a license as an Islamic cooperative engaged in microfinance activities and the ongoing supervision process carried out by regulators (Suzuki & Miah, 2018; Suzuki & Miah, 2018).

Furthermore, an investigation should delve into the specific regulations governing financial products offered by Islamic cooperatives. These regulations should ensure that products comply with Sharia principles while also meeting the needs of clients seeking microfinance services. Another vital aspect is understanding how risk management practices are regulated within these institutions. Given their unique nature, it is important to investigate whether there are specific guidelines or requirements regarding risk assessment, mitigation strategies, and reserves management tailored specifically for Islamic cooperatives engaged in microfinance (Rahmawati & Rinaldi, 2021). By thoroughly investigating the regulatory framework surrounding Islamic cooperatives engaged in microfinance activities, we can gain insights into how these institutions navigate within a specialized financial system while ensuring compliance with Sharia principles and promoting financial stability for their clients. Such an investigation will contribute valuable knowledge to understanding the key elements that have led to the prosperity of Islamic cooperatives as microfinance institutions (Vogel, 2013; Suzuki & Miah, 2018).

Stakeholder Engagement: A Key Element for Economic Empowerment and Community Development

In the realm of microfinance institutions (MFIs), stakeholder engagement plays a crucial role in fostering economic empowerment and community development. As such, it becomes imperative to investigate how stakeholder engagement contributes to the prosperity of an Islamic cooperative functioning as an MFI (Rahmawati & Rinaldi, 2021). Firstly, stakeholder engagement ensures that all parties involved have a voice and are actively participating in decision-making processes. By involving stakeholders such as clients, employees, investors, and regulators, the MFI can address their unique needs and concerns. This inclusivity fosters a sense of ownership among stakeholders, leading to increased commitment and dedication towards the institution's success. When stakeholders feel valued and heard, they become

more willing to contribute their resources – be it financial or intellectual – towards the cooperative's growth (Sawmar & Mohammed, 2021). Secondly, effective stakeholder engagement promotes transparency and accountability within the MFI. By openly communicating with stakeholders about its operations, financial performance, risk management practices, and social impact initiatives, the institution builds trust among its constituents. Stakeholders are more likely to support an MFI that demonstrates integrity in its dealings with clients and investors alike. Moreover, this transparency allows for constructive feedback from stakeholders which can be used to improve policies and practices (Sawmar & Mohammed, 2021). Thirdly, stakeholder engagement helps build strong relationships between the MFI and its surrounding communities. By involving local residents in decision-making processes related to loan disbursement or determining lending priorities based on community needs assessment exercises, MFIs can tailor their services accordingly. This localized approach not only ensures that financial services are accessible but also addresses specific socioeconomic challenges faced by communities. Overall, stakeholder engagement proves to be a key element for economic empowerment and community development within an Islamic cooperative functioning as an MFI. Through inclusive decision-making processes that foster transparency and accountability while considering local contexts, MFIs can create sustainable models that uplift individuals while benefiting society at large (Harahap et al., 2023).

Governance and Transparency: Unveiling the Factors behind the Cooperative's Prosperity

In the realm of microfinance, governance and transparency play a pivotal role in ensuring the success and sustainability of institutions. This subtopic aims to shed light on the key elements that led to an Islamic cooperative's prosperity as a microfinance institution (Trabelsi, 2021). One crucial factor contributing to the cooperative's success is its robust governance structure. The cooperative operates under a well-defined organizational framework that emphasizes accountability, participatory decision-making, and ethical practices. A clear separation of powers between management, board members, and members ensures checks and balances within the institution. Regular meetings are held where decisions are made collectively, fostering transparency and inclusivity ("2021 trafficking in persons report," 2021).

Transparency is another critical element that drives this cooperative's prosperity. The institution actively promotes openness by providing comprehensive information to its members regarding financial matters, operations, policies, and procedures. Transparent reporting mechanisms ensure that all stakeholders have access to accurate data on financial performance, loan disbursements, repayments, and expenses. By doing so, trust is built among members and investors alike (Sawmar & Mohammed, 2021). Furthermore, this Islamic cooperative has embraced technology as a means to enhance transparency. It has implemented digital platforms for financial transactions which allow real-time tracking of loan applications and disbursements for both borrowers and investors. This technology-driven approach not only streamlines processes but also provides greater visibility into the cooperative's operations (Harahap et al., 2023).

The cooperative's commitment to strong governance practices extends beyond its internal operations; it also collaborates with external auditors to conduct regular audits ensuring compliance with regulatory requirements. These audits serve as an independent assessment

of the institution's financial health while bolstering confidence among stakeholders (Shu, 2023).

In conclusion, effective governance structures coupled with transparency have been instrumental in driving the prosperity of this Islamic cooperative as a microfinance institution. By prioritizing accountability, participatory decision-making processes, transparent reporting mechanisms, technological advancements, and external audits; this institution has established itself as a trusted and successful player in the microfinance landscape.

The Role of Islamic Principles in Driving Financial Inclusion through Microcredit Programs

The role of Islamic principles in driving financial inclusion through microcredit programs is a crucial aspect that has contributed to the prosperity of Islamic cooperatives as microfinance institutions. Islamic principles emphasize the importance of social justice, ethical behavior, and economic fairness, which align with the goals of microcredit programs aimed at providing financial services to those who are excluded from traditional banking systems (Khaleequzzaman, 2020).

One key principle that drives financial inclusion through microcredit programs is the concept of "riba" or interest-free lending. In Islamic finance, charging interest is prohibited as it is considered exploitative and unjust. Instead, microcredit programs offered by Islamic cooperatives adopt profit-sharing models or provide loans without any additional charges. This approach not only encourages economic empowerment but also ensures that individuals have access to affordable credit without falling into a cycle of debt (Trabelsi, 2021).

Additionally, another principle that plays a significant role in driving financial inclusion is "zakat," which refers to mandatory charitable giving in Islam. Islamic cooperatives often allocate a portion of their profits for charitable purposes and community development initiatives. By incorporating zakat into their operations, these institutions promote social welfare and upliftment among marginalized communities. This commitment to social responsibility enhances financial inclusion by channeling funds towards projects that create economic opportunities for individuals who lack access to formal financial services (Widiastuti et al., 2022).

Furthermore, Sharia-compliant financing practices prioritize ethical investments and discourage engaging in activities deemed harmful or exploitative such as gambling or usury. By adhering to these principles, Islamic cooperatives ensure that their microcredit programs are tailored towards sustainable development and support ventures that have positive social impacts (Suzuki & Miah, 2018).

In conclusion, the role of Islamic principles in driving financial inclusion through microcredit programs cannot be underestimated. The prohibition on interest-based lending, emphasis on charitable giving through zakat, and commitment to ethical investments all contribute significantly towards fostering economic empowerment and prosperity within marginalized communities served by Islamic cooperatives as microfinance institutions (Rahmawati & Rinaldi, 2021).

Assessing the Impact of Stakeholder Engagement on the Cooperative's Success

Stakeholder engagement plays a pivotal role in shaping the success of any organization, including microfinance institutions like Islamic cooperatives. In the case of an Islamic cooperative operating as a microfinance institution, stakeholder engagement becomes even more critical due to its unique nature and purpose. This subtopic aims to explore and assess

the impact of stakeholder engagement on the prosperity and growth of an Islamic cooperative as a microfinance institution.

Firstly, it is essential to understand who these stakeholders are in an Islamic cooperative. They can include members, clients, investors, employees, regulators, religious scholars, and community leaders. Each stakeholder group has specific interests and expectations from the cooperative. Assessing their level of engagement and satisfaction is crucial for understanding how their involvement contributes to the success or failure of the institution.

One aspect to consider when evaluating stakeholder engagement is their level of participation in decision-making processes within the cooperative. Meaningful involvement empowers stakeholders by providing them with a sense of ownership and influence over strategic decisions. When stakeholders feel that their voices are heard and valued, they are more likely to actively contribute towards achieving common goals. Moreover, effective communication channels between stakeholders can significantly impact an Islamic cooperative's success.

Transparent communication fosters trust among members and clients while ensuring that information flows smoothly between all parties involved. Regular communication updates regarding financial performance, social impact achieved through microfinance activities, or changes in policies help maintain stakeholder interest and support. Additionally, stakeholder engagement can also contribute to expanding market reach for an Islamic cooperative as a microfinance institution. Positive word-of-mouth recommendations from satisfied clients or referrals from community leaders can attract new customers who believe in the cooperative's mission and principles.

Conclusion

Assessing the impact of stakeholder engagement on an Islamic cooperative's success requires evaluating their level of participation in decision-making processes and assessing effective communication channels within the organization. Furthermore, stakeholder engagement can contribute to expanding the cooperative's market reach through positive recommendations and referrals.

Community Development Initiatives: Empowering Individuals through Islamic Microfinance

Islamic microfinance has emerged as a powerful tool for community development, enabling individuals to break free from the shackles of poverty and empower themselves economically. Through its unique principles and practices, this form of microfinance not only addresses the financial needs of marginalized communities but also fosters social and economic empowerment. One key element of Islamic microfinance is its emphasis on community development initiatives. Unlike traditional microfinance models that focus solely on providing financial services, Islamic microfinance institutions (IMFIs) actively engage in community development projects that have a lasting impact on society. These initiatives aim to empower individuals by addressing their holistic needs and creating an enabling environment for long-term prosperity. One such initiative is the establishment of vocational training centers within the communities served by IMFIs. By equipping individuals with practical skills, these centers enable them to secure employment or start their own businesses, breaking free from the cycle of poverty. Moreover, these training programs are tailored to meet the specific needs of each community, ensuring that individuals acquire skills that are in demand locally.

In addition to vocational training centers, IMFIs promote entrepreneurship by providing business development support and guidance. They offer specialized training programs that equip aspiring entrepreneurs with knowledge about business planning, marketing strategies,

financial management, and risk mitigation techniques. By nurturing a culture of entrepreneurship within communities, IMFIs facilitate sustainable income generation activities and stimulate local economic growth (Khaleequzzaman, 2020).

Furthermore, IMFIs recognize the importance of education in empowering individuals and communities. They channel resources towards educational scholarships for underprivileged students or provide low-cost education financing options. This ensures that education becomes accessible to those who would otherwise be unable to afford it. Overall, through their community development initiatives, Islamic microfinance institutions play a pivotal role in empowering individuals by addressing their comprehensive needs beyond mere financial assistance. By combining financial services with vocational training centers, entrepreneurship promotion programs, and educational opportunities – IMFIs contribute to the sustainable development and prosperity of marginalized communities.

Sharia Compliance as a Catalyst for Economic Prosperity within an Islamic Cooperative

Sharia compliance plays a pivotal role in driving economic prosperity within an Islamic cooperative. The adherence to Islamic principles and values not only ensures ethical practices but also fosters trust and confidence among stakeholders. This subtopic explores how sharia compliance acts as a catalyst for the success of microfinance institutions within the Islamic financial system. Firstly, sharia compliance ensures that all financial transactions are conducted in accordance with Islamic teachings. Interest-free lending, known as *riba*, is strictly prohibited in Islam. Instead, profit-sharing mechanisms such as *Mudarabah* and *Musharakah* are employed, where borrowers and lenders share both risks and profits. This creates a fairer system that promotes economic inclusivity and encourages entrepreneurial activities within the cooperative. Secondly, sharia compliance emphasizes social responsibility by promoting equity and justice in financial dealings. *Zakat*, one of the five pillars of Islam, requires Muslims to give a portion of their wealth to support those in need.

Islamic cooperatives often allocate funds towards social welfare projects or provide interest-free loans to low-income individuals for income-generating activities. By fulfilling their religious obligations through these initiatives, cooperatives enhance their reputation and gain community support. Moreover, sharia-compliant financing practices foster trust between the cooperative and its members. The transparency inherent in these practices cultivates strong relationships based on mutual understanding and cooperation.

Members feel confident that their investments are managed ethically and responsibly by the cooperative's management team. Additionally, adherence to sharia principles attracts a specific target market consisting of individuals who prefer ethical financial services aligned with their religious beliefs. This niche market has been growing rapidly over recent years due to increased awareness about Islamic finance worldwide. In conclusion, sharia compliance acts as a catalyst for economic prosperity within an Islamic cooperative by ensuring ethical conduct in financial transactions, promoting social responsibility, fostering trust among stakeholders, and attracting a niche market.

References

- 2021 trafficking in persons report. (2021). Retrieved from <https://www.state.gov/reports/2021-trafficking-in-persons-report/>
- Effendi, N., Herwany, A., & Masyita, D. (2018). Sustainability of Islamic Microfinance in Indonesia: A holistic approach. Retrieved from

- <https://www.abacademies.org/articles/sustainability-of-islamic-microfinance-in-indonesia-a-holistic-approach-7190.html>
- Harahap, B., Risfandy, T., & Putri, I. N. (2023). Islamic law, Islamic finance, and sustainable development goals: A systematic literature review. *Sustainability*, 15(8), 6626. doi:10.3390/su15086626
- Khaleequzzaman, M. (2020). Enhancing financial inclusion through sustainable Islamic Microfinance in Pakistan: A participatory products development perspective. *Palgrave Studies in Islamic Banking, Finance, and Economics*, 201-219. doi:10.1007/978-3-030-39939-9_8
- Malim, M. (2011). Islamic Microfinance: Solution to poverty alleviation? Retrieved from <https://www.eurekahedge.com/NewsAndEvents/News/222/Islamic-Microfinance-Solution-to-Poverty-Alleviation>
- Rahmawati, & Rinaldi, F. (2021). COVID-19 pandemic. *COVID-19 and Islamic Social Finance*, 171-188. doi:10.4324/9781003121718-15
- Sawmar, A. A., & Mohammed, M. O. (2021). Enhancing zakat compliance through good governance: A conceptual framework. *ISRA International Journal of Islamic Finance*, 13(1), 136-154. doi:10.1108/ijif-10-2018-0116
- Shu, C. (2023). Muslims come into the frame in Southeast Asia's fintech boom. Retrieved from <https://techcrunch.com/2023/04/27/muslims-come-into-the-frame-in-southeast-asias-fintech-boom/>
- Suzuki, Y., & Miah, M. D. (2018). Introduction. *Dilemmas and Challenges in Islamic Finance*, 1-8. doi:10.1201/9781315105673-1
- Trabelsi, M. (2021). The role of financial institutions in value chain finance in the Global South. Retrieved from https://www.memoireonline.com/11/21/12477/m_The-role-of-financial-institutions-in-value-chain-finance-in-the-global-south8.html
- Vogel, J. H. (2013). Islamic microfinance – prospects and challenges — Financier worldwide. Retrieved from <https://www.financierworldwide.com/islamic-microfinance-prospects-and-challenges>
- Widiastuti, T., Ningsih, S., Prasetyo, A., Mawardi, I., Herianingrum, S., Robani, A., ... Hady, A. F. (2022). Developing an integrated model of Islamic social finance: Toward an effective governance framework. *Heliyon*, 8(9), e10383. doi:10.1016/j.heliyon.2022.e10383