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**Economic Sustainability For Islamic Nanofinance Through Waqf-Sukuk  
Linkage Program (Case Study In Indonesia)**

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ABSTRACT

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This paper argues that sukuk potentially to be an Islamic nanofinance instrument for mobilizing fund to the very micro society. Further, collaboration sukuk and *waqf* can be an innovation for economic sustainability, particular to get low cost fund to finance the very micro society without interest rate. Hence, this paper attempts to: (1) Introduce nanofinance of microfinance institutions in Indonesia; (2) Introduce cooperative sukuk as a local wisdom of microfinance institution in Indonesia to finance the real sector; (3) Propose model of *waqf*-sukuk linkage program for nanofinance by synergizing Islamic banks, *waqf* institutions and microfinance institutions to encourage Islamic financial inclusion for the very micro society.

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## Introduction

Most developing countries have very micro society in large numbers. Indonesia is also famed for its large scale of very micro society. Most of them do not have access to bank financing, particularly in rural areas. A wide variety of microfinance institutions (MFIs) provide important contributions to them although it is certainly not a panacea for poverty, but it can prove itself as a useful tool in the fight against poverty. Asian Development Bank (ADB, 2000), Robinson (2001), Segrado (2005), Obaidullah & Khan (2008), Obaidullah (2008), Ali (2011), and Leikem (2012) see microfinance is a powerful poverty alleviation tool. It implies provision of financial services to poor and low-income people whose low economic standing excludes them from formal financial systems. These people are traditionally considered nonbankable, mainly because they lack the guarantees that can protect a financial institution against a loss risk.

Further, Musari & Simanjuntak (2016) mention some MFIs now become concern to the very micro society and they introduce a new term 'nanofinance' to provide opportunities for the very poor, very low income, and very micro enterprises to access financial services. Musari & Simanjuntak (2015), Muazir & Musari (2016), Musari (2016b) argue that there are 'very poor' which actually being a target of microfinance, but most banks do not yet accommodate them. Ascarya & Sanrego (2007) also mention that micro, small, medium enterprises (MSMEs) classification should be redefined to be able to reach the poor and low income society, to assist and guide them to move their businesses up until graduated and self reliant.

In absence of banking facility, the very poor and very low-income people also very micro enterprises often resorts money lending from relatives and acquaintances, but when such sources are not available they approach local moneylenders. Moneylenders can and do provide very flexible and fast service tailor-made to the needs of the borrowers but they are often charged exorbitant interest rates. Mitra (2009) mentions that interest rates charged by MFIs have attracted criticism. Bateman (2011) sees that MFIs charge lower interest rates than local moneylenders, they are still seen as imposing high rates on poor clients. In the early days, many MFIs said this was necessary to cover the high operational costs of providing tiny loans to the poor, but that interest rates would fall through competition. This argument had some validity initially. But interest rates have not fallen as much as predicted, and in some countries have remained very high. Duvall (2004) asserts interest rate ceilings are found in many countries throughout the world. With the expansion of microfinance in developing countries, many legislators and the general public have found it difficult to accept that small loans to poor people generally cost more than normal commercial bank rates. Though meant to

protect consumers, interest rate ceilings almost always hurt the poor by making it hard for new MFIs to emerge and existing ones to stay in business. In countries with interest rate caps, MFIs often withdraw from the market, grow more slowly, become less transparent about total loan costs, and/or reduce their work in rural and other costly markets. By forcing pro-poor financial institutions out of business, interest rate caps often drive clients back to the expensive informal market where they have no or little protection.<sup>47</sup>

In Indonesia, empirical studies show that some MFIs provide also nanofinance for the very micro society<sup>48</sup>. But, most of the nanofinance uses interest. In Islamic perspective, Musari & Simanjuntak (2015) asserts the practices of these MFIs do not sharia compliance because provide interest for loans despite relatively low and regarded not burden to the borrower. But, the presence of conventional MFIs in some countries which focusing to the nanofinance should be a reflection for IFIs to engage for this society. Islamic finance has a responsibility for furthering socio-economic development of the very micro society without charging interest.

Learn from the local wisdom of cooperative of Association of Farmers Group in Indonesia which empowers their community through sukuk, this paper believes that sukuk is potential to be an Islamic nanofinance instrument for mobilizing fund to the very micro society. Further, collaboration sukuk and *waqf* can be an innovation for economic sustainability, particular to get low cost fund. Hence, this paper attempts to: (1) Introduce nanofinance of microfinance institutions in Indonesia; (2) Introduce cooperative sukuk as a local wisdom of microfinance institution in Indonesia to finance the real

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<sup>47</sup> Groen (2002) mentions microfinance interest rates are set with the aim of providing viable, long-term financial services on a large scale. MFIs must set interest rates that cover all administrative costs, plus the cost of capital (including inflation), loan losses, and a provision for increasing equity. Unless MFIs do so, they may only operate for a limited time; reach a limited number of clients; and will tend to be driven by donor or government goals, not client needs. Only sustainable MFIs can provide permanent access to financial services to the hundreds of millions who need them. Although microcredit interest rates can be legitimately high, inefficient operations can make them higher than necessary. As the microcredit market matures in a given country or region, donors and others should pay more attention to reducing operating costs to ensure the most efficient, competitive interest rates possible.

<sup>48</sup> MFIs in some countries now become concern to the very micro society and they introduce a new term 'nanofinance' to provide opportunities for the very poor, very low income, and very micro enterprises to access financial services for emergency needs. Mahanti (2008) mentions nanofinance as small interest free loans to the poorest of poor women for their emergency needs. The main objective of nanofinance is to give small interest free loans for one year which will stop them to go to the loan shark. The women learn to help other women through nanofinance concept. Chonlaworn & Pongpirodom (2015) explain that nanofinance is a flexible credit process designed to meet the financial needs of customers. Loan targets are to promote better access to capital, increase occupational opportunities, and alleviate illegal lending.

sector; (3) Propose model of *waqf*-sukuk linkage program for nanofinance by synergizing Islamic banks, *waqf* institutions and microfinance institutions to encourage Islamic financial inclusion for the very micro society.

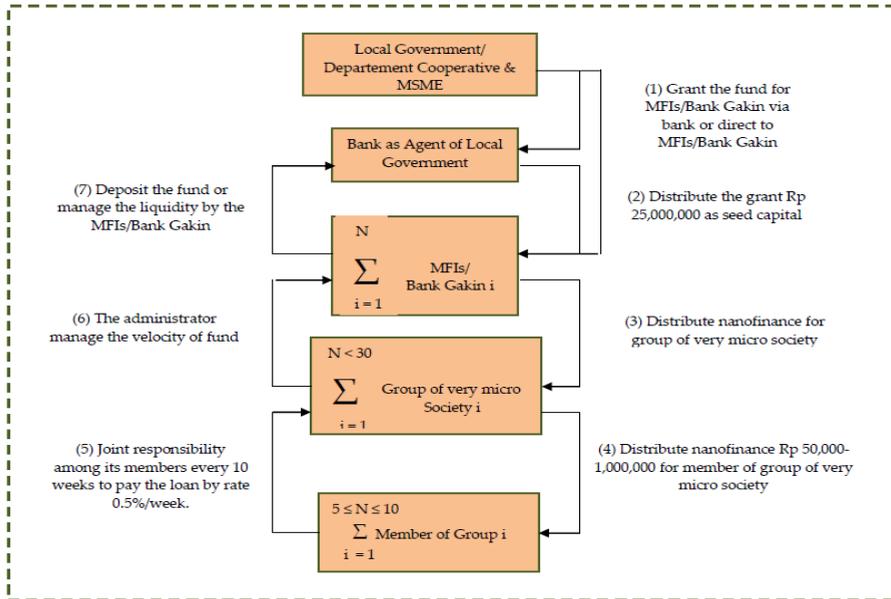
### **1. Lesson Learned from Nanofinance in Indonesia**

According to ADB (1997, 2000), institutional microfinance is defined to include microfinance services provided by both formal and semiformal institutions. MFIs refers to institutions that provide microfinance services. These may include non-governmental institutions, credit cooperatives, credit unions, and banks. Asia Foundation (2003) mentions that non-bank MFIs are an alternative for the microenterprises and/or the poor to obtain financial services. Banks are considered too bureaucratic by a majority of the micro enterprises and/or the poor. Banks are also unable to provide services to the poorest strata because the cost of servicing small loans is prohibitive. This consideration of profitability is believed to influence banks' unwillingness to channel microfinance.

Musari & Simanjuntak (2016), Musari (2016b, 2016c) claim most MFIs in Indonesia, Cambodia, Thailand, and India also do nanofinance for the very micro society. MFIs in those countries play a key role in providing financial services to the very poor, very low income, and very micro enterprises. Unfortunately, most of MFIs charge such high interest rates to the very micro society despite it looks relatively low and regarded not burden to the borrowers. But, if we compare to the bank interest rates per annum, the microfinance or nanofinance interest rates is higher because the costs of making a small loan are higher in percentage terms than the costs of making a larger loan.

In Indonesia, one of MFIs which provide nanofinance for the very micro society is MFI for Society that initiated by Department of Cooperative & Micro Small Medium Enterprises (MSMEs) and spread across the regency in Indonesia. In Jember, East Java Province, term of MFI for Society usually called by Bank for Poor Family or Bank Keluarga Miskin (Gakin). The term 'Bank Gakin' is given by very poor people who become its members and then used by the administrators and many people in Jember. Bank Gakin is an alternative financing for the very poor, very low income, and very micro enterprises rather than formal banks or moneylenders in there. The scheme of nanofinance by Bank Gakin can be seen in Figure 1.

**Figure 1:** Nanofinance Scheme of MFIs by Department of Cooperative & MSMEs



As Grameen Bank<sup>49</sup>, Bank Gakin in Jember also uses the principle of joint responsibility among its members. Bank Gakin actually is the collaboration of Grameen Bank's concept with cooperative concept. The Department of Cooperatives & MSMEs funds Rp 25 million for each Bank Gakin. Its main target is productive women. Each Bank Gakin consist a maximum of 200 poor people with predominantly 90% women become administrators and 46% of them are elementary school graduates and 5% had never undergone a formal school education. Bank Gakin serves about 30 groups with more than 150 households. Business group consisting of 5-10 people who can apply for unsecured business loans between Rp 50,000 to Rp 1 million.<sup>50</sup> People who

<sup>49</sup> Thousands of MFIs sprang up around the globe, the majority modeled closely on Classical Grameen Model and has been replicated in many countries in a wide variety of settings (Leikem, 2012). The model requires careful targeting of the poor and done by mostly of women group. The model requires intensive fieldwork by staff to motivate and supervise the borrower groups. Groups normally consist of five members, who guarantee each other's loans. A number of variants of the model exist; but the key feature of the model is group-based and graduated financing that substitutes collateral as a tool to mitigate default and delinquency risk. The main point of departure of microfinance from mainstream finance systems is its alternative approach to collateral that comes from the concept of joint liability (Obaidullah & Khan, 2008).

<sup>50</sup> Almost USD 4 to USD 77 with exchange rate USD 1 = Rp 13,000. In Indonesia, Rp 50,000 is very small value and bank certainly is not willing to serve the financing for the people who just need this value. Because of that, the people prefer to borrow into moneylender or MFIs.

apply for credit does not have to submit business proposals, especially through a convolution survey. Proposals can be submitted orally. Funds can be directly liquid after a survey conducted at a glance toward the business. With credit disbursement period of 10 weeks paid in installments every week by rate 0.5 percent. This mechanism is very helpful the group of very micro society.

Further, Bank Gakin today has gained positive response from the poor because make them easier to obtain loan for venture capital. In addition, the members feel their life are better because their incomes are increasing. Table 1 shows the progress of Bank Gakin during 10 years.

**Table 1:** Progress of Bank Gakin During 10 Years

Hal	Year									
	2006	2007	2008	2009	2010	2011	2012	2013	2014	
The Number of 'Bank' GAKIN	13	31	37	41	218	298	353	433	454	
The Number of Community (Group)	330	817	997	1,023	3,873	4,748	5,511	5,863	6,411	
The Member (People)	1,652	4,080	4,834	5,034	17,856	22,008	25,094	26,980	29,410	
The Amount of Loan (Million)	1,011	6,222	14,568	65,522	12,582	25,999	35,509	46,245	52,912	
Fee and Administration (Million)	30.4	327	763	343	573	1,380	1,259	1,780	2,165	
Current Earning (Million)	17	127	336	164	339	666	618	755	1,060	

**Source:** Department Cooperative & MSMEs Jember (Musari & Simanjuntak, 2015)

Hereinafter, in Islamic perspective, Bank Gakin's practice still does not meet sharia compliance. Nanofinance by Bank Gakin provides rate of interest for loans despite relatively low and regarded not burden to the borrower. Islamic finance is based on the premise that usury (interest-based lending) is prohibited and *ba'i* (trading of goods and services) is permitted. Interest rate hurts the very poor, very low income, and very low enterprises. In the name of humanity, the very micro society cannot be equated with the MSMEs in the term of bank's classification. Nanofinance actually is a humanitarian mission.

Another lesson learned from nanofinance in Indonesia is Kredit Melati (Credit Against The Lenders) by the Government of Bandung City.<sup>51</sup> For avoiding Bandung's residents from the loan shark, the government through its Rural Bank (BPR)<sup>52</sup> launched this program at May 2015. BPR is a banking

<sup>51</sup> Kredit Melati is a nanofinance and also microfinance. It is given while most of banks, and also rural banks, in the practices almost never distribute microfinance less than Rp 1 million. Kredit Melati provide also the loan for the very micro society by the plafond less than Rp 1 million.

<sup>52</sup> Ismal (2012), Muazir & Musari (2016) claim that one of the distinctive character of the Islamic financial system in Indonesia that can not be found in other countries is the diversity of Islamic financial institutions (IFIs) to serve MSMEs. Financing of MSMEs in Indonesia is done by Sharia Business Unit (UUS), Islamic Banks (BUS), Sharia Rural Bank (BPRS), Baitul Maal Wa Tamwil (BMT), Islamic Service Finance Cooperative (KJKS), and other Islamic MFIs. But, Musari & Simanjuntak (2015, 2016) also argue that Indonesian banks (also Islamic

institution in the lowest level in Indonesia that is most likely to commit nanofinance. In this program, the Bandung's residents may access the credit by zero percent interest.<sup>53</sup> However, the program has complaints by the residents, especially related to the disbursement of funds, because the bank cuts 8 percent of total funds as administration fee. For residents who late paying the loan installments, the BPR also impose interest 0.2 percent per day of the total installments. Another complaint is that the credit disbursement process can not be completed in one day as promised by the government because the bank must follow the regulations set by the authorities to do field survey, field analysis, and proof of residency so that more than one day.

**Table 2:** General Requirements of Kredit Melati

Loan Base	Rp 500 thousand -30 million
Interest Rate	0%
Time Periode	12 months
Membership	5-10 people
Disbursement Process Duration	1 day
Administration Fee	8% of total loan
Market Target	Groups: Business by region, type of business, gender, profession
	Personal: Trade, services, cottage industries
Guarantees managed by group	Household appliances, freehold Title (SHM), contract of sale (AJB), certificate of ownership of motor vehicles (BPKB), time deposit & saving account, professional licence.
Guarantees managed by personal	Freehold Title (SHM), contract of sale (AJB), certificate of ownership of motor vehicles (BPKB), time deposit & saving account, professional licence.

**Source:** Local Company (PD) Rural Bank (BPR) of Government of Bandung City

Thus, Kredit Melati in overall is a loan granted collectively for a group system that is distributed to the small business communities in order to narrow the work space of loan shark, empower micro businesses, and encourage the creation of new entrepreneurship.

## 2. Cooperative Sukuk

A lesson learned from other MFIs in Indonesia, at 2009, Department of Cooperatives and MSMEs tried to change the nanofinance scheme of Bank

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banks) in the fact does not reach microfinance to the very micro society which consist the very poor, very low income and very micro enterprises.

<sup>53</sup> In the term of Islamic finance, what Kredit Melati do is the practice of *qardhul hasan*. In *qardhul hassan*, a loan in which the debtor is only required to repay the amount borrowed. *Qardhul hassan* is a loan extended without interest or any other compensation from the borrower. The lender expects a reward only from Allah.

Gakin. The fund source was not grant, but as loan from the local government to Bank Gakin. Then, Bank Gakin must return the fund via bank agent of local government. Based on the result of evaluation, the seed capital of Bank Gakin cannot be sourced from loans, but it should be a grant (Musari & Simanjuntak, 2016). This is in line with Leikem (2012) that was found that savings are vital and are perhaps more important to the poor, that the poorest are probably better served by direct subsidies rather than loans. Obaidullah (2008) proposes the Islamic alternative to interest-based conventional loan is trade-based or lease-based credit that permit the ownership and/or use of commodities or physical assets needed for productive enterprise while deferring the payments to future time periods.

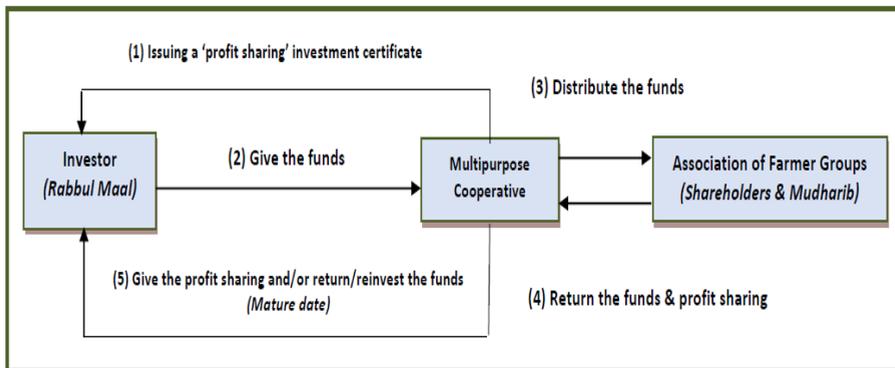
So, in order to eliminate the interest rate on nanofinance, it is necessary to get low cost fund to finance the very micro society. Sukuk is a good alternative for the mobilization of funds that is not in the form of interest-based loans. Sukuk now becomes a global economic phenomenon across religions, cultures, nations and being a part of the global financial system. A number of non-Muslim countries also participate in issuing sukuk as their national economic policy. This shows sukuk has proven to be a universal and acceptable Islamic finance instrument by non-Muslim. Ismal & Musari (2009a, 2009b, 2009c), Musari (2015a) argue sukuk is better to be a financing alternative than debt financing because of its elements of investment cooperation, sharing of risk, and engagement of assets or the real project as its underlying issuance. Sukuk can be used to finance the economy and reduce the government's dependence on foreign debt through the utilization of idle funds in the domestic. For Islamic bank and finance industry, sukuk can serve as an instrument to manage liquidity and portfolio. Ali (2007), Ali (2011) assert sukuk provide an opportunity for IMFI's. In relation to finance the micro-enterprises, funds generated through issuances of sukuk shall be used to provide financing on the basis of profit sharing modes by the special purpose entity.

In Indonesia, Musari (2012, 2013, 2015a, 2015b, 2016a), Simanjuntak & Musari (2014) explain sukuk has been practiced by cooperative of Association of Farmer Groups as a local wisdom to finance the working capital of farmers. In this context, sukuk has been a microfinancing instrument for their community. To overcome the difficulties in banking financing, primarily to avoid the high interest-based loan, the cooperative of Association of Farmer Groups issues an investment certificate. This certificate is an ownership paper to finance the cocoa businesses and such certificate is based profit sharing

contract<sup>54</sup>. According to the terms of Islamic economics and finance, the investment certificate issued by the cooperative is sukuk.

At least there are three lesson learned of sukuk issued by this Association of Farmer Groups. **First**, empirical fact in Indonesia shows conventional MFI has issued sukuk for the very micro society. **Second**, this sukuk using profit sharing contract when most of existing sukuk in Indonesia and the world using *ijarah* contract. Profits are distributed in percentage agreed beforehand.<sup>55</sup> **Third**, Association of Farmer Groups in Indonesia has proven that bank financing is not the only way for the farmers to have financing access. Through cooperative investment with some people, strengthening networks, and intensive coaching, Association of Farmer Groups has raised the wealth distribution. Overall, the scheme of cooperative sukuk by the Association of Farmer Groups is shown in Figure 1.

**Figure 2:** The Structure of *Mudharabah* Sukuk by the Association of Farmer Groups



**Source:** Musari (2015a), Be Modified

<sup>54</sup> In Islamic finance term, it is similar as *mudharabah* contract. In *mudharabah*, the investor contributes funds, and the Association of Farmer Groups contributes expertise and works to execute a potentially successful project. In relation to *mudharabah* contract, study of Daneshfar, Simyar, Roller and Wnek (2010) suggest that one of financing arrangement that give a fair treatment is profit sharing among the stakeholders involved in the agricultural activities. There are several motives for the adoption of profit sharing such as labor productivity, cost monitoring, and wage flexibility. In addition, profit sharing could create a self-motivated stakeholders to achieve the challenging goals of the company. Several studies also have found profit sharing as an effective compensation scheme.

<sup>55</sup> In this Association of Farmer Groups, refer to Musari (2015a), the formula used for calculating a monthly profit sharing to each holder of sukuk is Capital times Rp 75 or Price of cocoa per kg times Frequency of deposit or approximately 1.56% or 18.72% per year. This rate of return is not fixed, but fluctuates depending on the outputs of the Association of Farmer Groups. However, the real value is not far from the expected range of outputs.

### 3. *Waqf*-Sukuk Linkage Program

An-Naf (2005) mentions the requirements of economic sustainability are: economic efficiency, economic welfare, and distribution of wealth. Siddiqi (2002) claims the monetary and fiscal policies recommended to improve the system's efficiency are often complicated and unconvincing. Some of them may be politically impossible to implement. In this situation, any simple and straight forward approach like that of Islamic economics is bound to attract attention. Chapra (1979) asserts the concept of welfare in Islam provides a spiritual orientation to all material effort and creates a harmony between the innate spiritual and material urges of individuals and groups. Islam has so firmly and exquisitely dovetailed the spiritual and material aspects of life that they may serve as a source of mutual strength and together serve as the foundation of true human welfare and happiness. According to Islam, negligence of either of the two aspects of life will prevent mankind from achieving true welfare. In fact there is no division between material and spiritual aspects of life in Islam. According to Ackerman et al (1998), welfare inequality should be followed by the distribution of wealth.<sup>56</sup> Muazir & Musari (2016) mention Islamic finance in new institutional economics (NIE) perspective have responsibility to carry out the distributive justice through the distribution of wealth which in turn will reduce poverty and inequality.

Further, Kahf (2008) argues the minimization of distributive inequality can be achieved by the education system, guarantee to get the same opportunity, and the distribution of *zakah*, *infaq*, *sadaqah*, *waqf*. *Zakah* and *waqf* can be used to provide microfinancing to the poor. Hassan (2010) affirms the challenges of conventional microfinance can be resolved if it is designed in an integrated manner by incorporating the two basic and traditional institution of Islam, the *waqf* and *zakah*, with Islamic microfinance into a single framework. Since Islamic financing modes are based on principle of social justice and equity and *riba* is prohibited, Islamic MFIs are likely to yield better benefit if they are properly designed. In addition, borrowers will have lower refundable loan, as a result of utilization of *zakah* funds, it will result in less financial burden on the poor.

So, in order to integrate the mission of Bank Gakin (and also other conventional MFIs which concerned to nanofinance) and take the lesson learned from sukuk for microfinance of Association of Farmer Groups, this paper promote the nanofinance as financial program for the very micro society. This paper believes that sukuk potentially to be an Islamic nanofinance

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<sup>56</sup> There are at least three reasons why the distribution of wealth needs to be done. First, ownership of financial wealth is a significant source of revenue. Second, offer a wealth of security. Third, wealth leads owner to have political and economic power.

instrument for mobilizing fund to the very micro society. Then, collaboration sukuk and *waqf* can be an innovation for economic sustainability<sup>57</sup>, particular to get low cost fund to finance the very micro society without interest rate.<sup>58</sup> In the area of *waqf*, with many of *waqf* assets or cash, sukuk issuance can therefore be regarded to finance the development of *waqf* properties or using them to be underlying asset. The integration of sukuk and *waqf* in a single structure is an interesting development that is worth pursuing.<sup>59</sup>

### 3.1 Mudharabah Waqf-Sukuk

Actually, many schemes can be applied in *waqf*-sukuk. One of them is *waqf*-sukuk linkage program for MFIs/IMFIs that bridging the Islamic banks or retail/corporate investor and *waqf* institution through special purpose vehicle (SPV). Figure 3 shows SPV using *waqf* asset as underlying and also being a project to issue *mudharabah* sukuk for Islamic banks or retail/corporate investor. The fund of sukuk then be used to develop a project by developer or management for project of *waqf* properties. The return of project activity will flow to Islamic banks or retail/corporate investor. Particular to Islamic banks, the return will be used to finance the very micro society through MFIs/IMFIs

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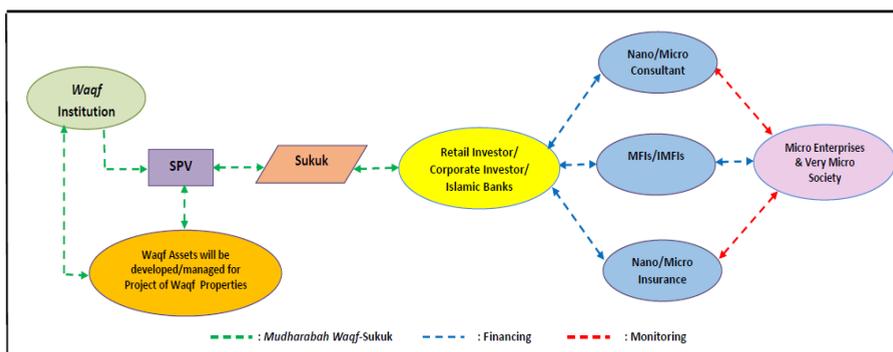
<sup>57</sup> In addition to *tijarah* contract, *fiqh muamalah* in Islamic finance also known *tabarru'* contract which can be a policy alternative in developing social and economic life of society. *Waqf* is one of the instrument of *tabarru'* contract which has advantage for managing liquidity in the economy and can be used to finance the real economy. *Waqf* actually can be integrated in the financial sector to enhance growth and welfare. In practice, many *awqaf* have become unproductive assets and not created for socio-economic purposes.

<sup>58</sup> The tendency to use the third sector become a global trend. This is because the first sector and the second sector of the economy has failed to ensure the attainment of human well-being, both in the national and global level, which is based on market forces. By giving more to the strength of the third sector, it is expected to play a big role on poverty eradication. This is also an effort to ensure that the poor will get financial services by presenting a guarantee or collateral (Sanrego & Taufik, 2016).

<sup>59</sup> *Waqf* institution has long been recognized and had a vital role in the history of the Muslim world. However, current *waqf* institution through out the Muslim world has declined in effectiveness due to lack of management. Hence, *waqf* institutions need enhancement to revive back its vital role. The institution can be revitalized by turning it to become a productive *waqf*. Productive *waqf* will not only be a self-financing *waqf* but it also can finance the primary project of the *waqf* (Sadeq, 2002). *Waqf* can provide a social and economic welfare of society when empowered (Sanrego & Taufik, 2016). *Waqf* is subject to *Ijtihad* which rules that it must be benevolent. The static perpetuity, rigidity and historical mismanagement of *waqf* created inefficiencies and ineffectiveness that can be avoided by good governance. However, the perpetuity of *waqf* is compulsory and its benefits in developing *waqf* assets should be Shari'ah-compliant. This can be ensured through a transparent relationship between *waqif*, *mutawalli*, *waqf* board and *maukuf'alah*, which accomplish *waqf* objectives, monitors performance, and assures compliance with Islamic Shari'ah rules and principles (Masayita, 2012).

or nanofinance institution by nanofinancing based-*qardhul hasan*.<sup>60</sup> Then, through the return of *waqf*-sukuk, these institutions may have low cost funds to finance the very poor, very low income, and very micro enterprises without interest rate.<sup>61</sup> MFIs/IMFIs do nanofinancing to the member of group about Rp 50 thousand – 1 million through *qardhul hasan* or *mudharabah/musyarakah* contract. Then, the MFIs/IMFIs or nanofinance institution in maturity date will return the fund of *qardhul hasan* to Islamic banks.

**Figure 3: Mudharabah Waqf-Sukuk**



Source: Musari & Simanjuntak (2016), Be Modified.

### 3.2 Musyarakah Waqf-Sukuk

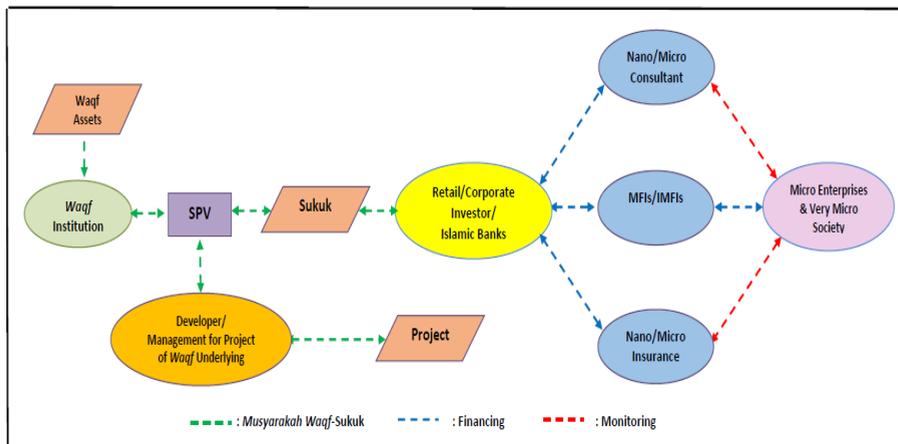
Same as the *mudharabah waqf*-sukuk, *musyarakah waqf*-sukuk to the member of Islamic cooperatives may provide low cost funds to finance about Rp 50 thousand – 1 million through *qardhul hasan* or *mudharabah/musyarakah* contract. Then, the Islamic cooperatives in maturity date will return the fund of *qardhul hasan* to Islamic banks. *Mudharabah waqf*-sukuk and *musyarakah waqf*-sukuk is a form of the partnership financing, the core element of Islamic finance, which provides an important source of funding for the very micro society that might not be able to take on debt financing.

<sup>60</sup> Sanrego & Taufik (2016) mentions the quality of loan payments by poor people who do not have a strong social capital capacity, tend to be bad. Kahf (1997) argues sharia give more priority for *qard hasan* than *infāq* because *qard hasan* bring the honour for the borrowers and encourage him to struggle and strive.

<sup>61</sup> This idea in line with Elgari (2004), Ahmed (2004, 2007) who propose establishing a nonprofit financial intermediary through *qardhul hasan* that gives interest free loan to finance consumer lending for the poor. The capital of the bank would come from monetary (cash) *waqf* donated by wealthy Muslims. The returns from *waqf* and funds from *sadaqat* can be used to finance productive microenterprises at subsidized rates.

*Musarakah waqf-sukuk* also integrates SPV, *waqf* institution, Islamic banks or retail/corporate investor, and developer or management for project. Figure 4 shows *waqf* institution uses *waqf* asset as underlying to issue by SPV for Islamic banks or retail/corporate investor as the supplier of fund. Then, the fund of sukuk will be used to develop a project by developer or management for project. The *waqf* institution, SPV, Islamic banks or retail/corporate investor, and developer or management for project each other agree to have share in the project. Next, developer or management for project reach the return of project activity and flow to the share holder. Particular to Islamic banks, the return will be used to finance the very micro society through Islamic cooperative by nanofinancing based-*qardhul hassan*. Islamic cooperatives may have low cost funds to finance the emergency needs of the very poor, very low income, and very micro enterprises without interest rate.

**Figure 4:** *Musarakah Waqf-Sukuk*



Source: Musari & Simanjuntak (2016), Be Modified.

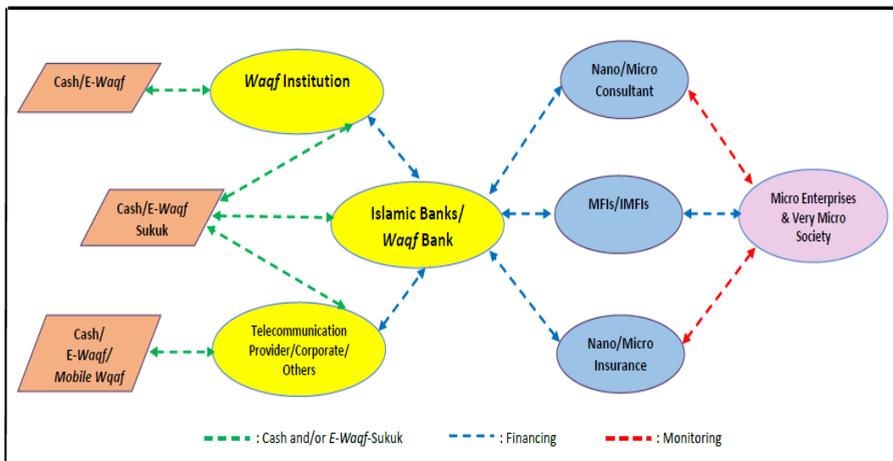
### 3.3 Cash and/or E-Waqf-Sukuk

Jalil & Ramli (2008) mention cash and e-*waqf* fund is considered as the easiest means for the public to join *waqf* scheme because they are only obliged to donate their money in cash or deducting from their bank account via e-*waqf* facility. Ahmed (2004, 2007) believes the capital of the bank would come from monetary (cash) *waqf* donated by wealthy Muslims. The returns from *waqf* and funds from *sadaqat* can be used to finance productive microenterprises at subsidized rates. Çizakça (1998) explains cash *waqf* was a special type of endowment and it differed from the ordinary real estate *waqf* in that its original capital, *asl al-mal* or, corpus, consisted purely or partially, of cash. The earliest origins of the cash *waqf* may be traced back to eighth century, when Imam Zufar was asked how such *waqf* should function. The fact that such a

question was asked at all may be taken as an indication of the existence of such *awqaf* at that time.

The important thing in this proposed scheme is redesigning the cash/*e-waqf*-sukuk such that they contribute not only to capital redistribution but also to capital accumulation. Adopted from Aziz, Johari & Yusof (2013), the Islamic bank can be entrusted to issue cash/ *e-waqf*-sukuk and/or collect cash/*e-waqf* from the public via *waqf* institutions or telecommunication provider (through mobile *waqf*) or corporate or other institutions for special purposes disclosed and easily available to the donating public. Once such deposits are made, the bank can disburse the cash, which is dedicated for nanofinance to meet the emergency needs of the very micro society through Islamic cooperatives. Then, the very micro society can borrow the fund based-*qardhul hassan*. The repaid amount can be once again loaned to another. This will be repeated whenever an amount is available in the given fund. The cash can be maintained perpetually, provided compensations for losses and market fluctuations are planned and paid. For this, a special account called the reserves account will be needed. As the loan's fund will be disbursed interest free and minimum service charges will be imposed on borrowers and have simple processing system.<sup>62</sup> Figure 5 shows the proposed scheme of cash/*e-waqf*-sukuk. This scheme is more fitting to be applied for nanofinance given the prominence of cash/*e-waqf* more flexible than other types of *waqf*.

**Figure 5:** *Cash/E-Waqf*-Sukuk for Nanofinance



In this scheme, *waqf* institutions or telecommunication provider or corporate or other institutions which organizing *waqf* fundraising may have profit

<sup>62</sup> It is becoming a key requirement for Islamic nanofinance, including conventional nanofinance, to give interest free loan, minimum service charges, and simple processing system.

sharing from the cash/e-*waqf*-sukuk of Islamic bank. They may also have incentive or other facilitation from the Islamic bank which become one of the features of the cash/e-*waqf*-sukuk. This scheme also encourages to establish *waqf* bank in the future for managing all *waqf* asset, including for issuing cash *waqf* certificate or *waqf*-sukuk or government *waqf* certificate. In contrast to other Islamic contract, the *waqf* contract does not recognize due date. Optimizing *waqf* also could be more widespread because there is no qualification of *mustahiq*. Thus, the funds are absorbed by *waqf* contract fully to finance the *maslahah* of *ummah*, including activities that support the very micro society and MSMEs. In this context, *waqf* can take a role as an instrument of monetary and fiscal which help each other to manage excess liquidity. Islamic economic system is stressing the importance of a balance between the real sector and financial sector. *Waqf* can be the bridge that unite these two sectors. Overall, according to the principle that lending is better than giving, the generic concept of Islamic nanofinance through *waqf*-sukuk may be adopted the conventional cooperative by bridging philanthropy/*waqf* institutions and MFIs/IMFIs.

## Conclusion

Lesson learned from nanofinance in Indonesia show that financial institutions which provide this service for the very micro society can not avoid the interest rate, either directly or indirectly. Interest rate hurts the very poor, very low income, and very low enterprises. High interest rates to the very micro society despite it looks relatively low and regarded not burden to the borrowers actually is caused by the costs of making a small loan is higher in percentage terms than the costs of making a larger loan. Whatever the reasons, in Islamic perspective, this practice does not sharia compliance.

This paper may show that sukuk potentially to be an Islamic nanofinance instrument for mobilizing fund to the very micro society. Empirical study in Indonesia find that MFI can issue sukuk as a financing instrument to fund the farmers and do profit-loss sharing to the investors. Lesson learned from the Association of Farmers Group in Indonesia which empowers their community through sukuk, this paper believes that sukuk is also potential to be an Islamic nanofinance instrument for mobilizing fund to the very micro society. Sukuk has been practiced in Indonesia as a local wisdom to find an alternative financing for working capital of the farmers.

Then, collaboration sukuk and *waqf* can be a funding source to get low cost fund to finance the very micro society to avoid interest. The issuance of sukuk can be regarded to finance the development of *waqf* properties or using them to be underlying asset. The structure of *waqf*-sukuk can be integrated into nanofinance program to effectively alleviate absolute poverty through *qardhul hassan* or *mudharabah/musyarakah* contract. *Mudharabah waqf*-

sukuk, *musyarakah waqf*-sukuk, cash/e-*waqf*-sukuk can be schemed to make them easier for the very poor, very low income, and very low enterprises to break out of the poverty cycle. The lesson from the cooperative of Association of Farmer Groups in Indonesia indicates that cooperative can issue sukuk as a financing instrument to fund the farmers and do profit sharing to the investors. Sukuk has been practiced in Indonesia as a local wisdom to find an alternative financing for working capital of the farmers. It proves that sukuk has an ability to be a tool for managing the lack and excess of liquidity, bridging the financial sector and real sector, and doing nanofinance (also microfinance) for the very micro society. Sukuk for nanofinance (also microfinance) is not just a discourse.

Finally, this paper encourages for doing Islamic financial inclusion to the very micro society through Islamic nanofinance so that they free from the loan sharks and the interest. The practice of nanofinance in line with the mission of Islamic economics. Islamic nanofinance needs the synergizing of Islamic banks, *waqf* institutions and Islamic cooperatives to finance the very micro society. Islamic nanofinance also needs nano consultant and nano insurance/nano takaful as the pillars to empower the very micro society because Islamic nanofinance also has to work to release people from their reliance on debt. *Wallahua'lam bish showab.*

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