CHAPTER IV
DEVELOPMENT OF ISLAMIC BANKING AND FINANCE IN INDONESIA AND BRUNEI.

INDONESIA

Indonesia, with an estimated population of about 200 million people out of which about 90 per cent are Muslims, is the largest Muslim country in the world and, of course, the biggest country in South-East Asia. The Indonesian population, however, is not entirely homogeneous. There are over 300 ethnic groups and more than 250 district languages in Indonesia today. With the total land area of 1,904,569 square kilometers spread over 13,677 islands throughout the Indonesian archipelago in which the five main islands are Sumatra, Java, Sulawesi, Kalimantan (which makes up two-thirds of the Island of Borneo), and Irian Jaya (which consists half of the island of New Guinea), the heterogeneity that characterizes Indonesia is understandable. Java is the most populous island with more than half of Indonesia's total population.¹

In spite of the size of its Muslim population, Indonesia has long prided itself in being a secular state espousing the ideas of Pancasila which symbolize its national ideology,² and committed itself to the peaceful co-existence of all different religious denominations. The application of Islamic Law is accepted only to the extent that it is allowed by adat (customs).³ Religious courts have a limited jurisdiction. Although Muslim family law is officially used for Muslims, in terms of implementation, some of the procedures appear secular in character. A religious council was established in 1962 and reorganized in 1975 to assume responsibility for issuing fatwa (decrees) on matters of religion to the government and the people.⁴
Informal Arrangements Of Islamic Credit Societies in Indonesia

It is not easy to establish an Islamic bank in societies where there is a lack of social commitment to the ideals of Islamic banking or where there is no government support for it. For, the establishment of an Islamic bank would call for not only substantial capital and special skills but also government support. In societies where Muslims constitute a majority with political muscle but lack of strong commitment to Islamic ideology, it would be extremely difficult for Islamic banking to take root. Under such circumstances, pious Muslims have tended to resort to informal arrangement, which would allow interest-free financial transactions within the Islamic framework.

In the case of Indonesia, which subscribes itself to the Pancasila ideology, there has been a tendency to draw a hard and fast line between religion and politics and consequently Islam appears to have been reduced to the religion of rituals. Moreover, the intellectual tradition in Indonesia in modern time can be said to have not been conducive to the idea of interest-free banking. There are several well-respected Indonesian intellectuals such as Hatta,\(^5\) who has argued that *riba* that is prohibited in Islam is not the same as the interest charged or offered by modern commercial banks. According to him, the term *riba* refers to usurious rate charged on loans for consumption purpose, while interest in commercial banking transaction is not exploitative in the sense that it facilitates the production process in the economy. In other words, he associates *riba* with high rates of interest and consumption credit and hence *haram* (prohibited) and regards upon moderate interest on productive loan is not only *halal* (permissible) but also necessary to promote economic growth and equitable income distribution by putting informal moneylenders out of business. The establishment and operation of banking institutions in Indonesia are more or less based on Hatta’s theory of legitimization of interest.\(^6\) However, there are many scholars who have alternative ideas against the institution of interest. Thus, scholars such as H. M. Bustami and K. H. Mas Masur, who hold the idea that interest in whatever form is *haram*\(^7\).
Many traditional lending-borrowing organizations involve an interest element in one form or another. One may rightly conclude that Indonesian society condones interest so long as the rates are considered moderate or low. Thus, the Koperasi Simpan Pinjam (Saving-Lending Co-operative) has been criticized for charging exorbitantly high interest rates, while saving-lending transaction under the Usaha Bersama (common enterprise, production, and marketing) system, which allows a member of the group to borrow in proportion to his savings, at relatively low rate of interest, is considered good. Many of such institutions that charged low interest rate are Badan Koordinasi Koperasi Kredit (BKKK) (Credit Union of Indonesia) which has mobilized 1,234 saving-lending groups, providing Rp 5.3 billion as loans in 1984. Although interest is charged on loan at the rate of 3.5 per cent per month, the interest income is added to the loan fund to be used by members. Another experiment which has some semblance of Islamic banking is the credit programme called the 'qirodh' system which has been in existence since 1982 under the auspices of the LP3ES (Lembaga Penelitian, Pendidikan dan Penerangan Ekonomi Social or the Institute of Economic and Social Research, Education and Information). The programme is targeted at small-scale entrepreneurs, rural woman, and cottage industry operators. Although the programme entails saving-lending activities at interest rate of about 3 per cent per month, the main thrust of the scheme is that 'qirodh' model which, in essence, amounts to profit-sharing, with 60 per cent of the profit accruing to the clients, 20 per cent being retained as group savings and the remaining 20 per cent earmarked to meet the cost of administering the programme. It is of interest to note that, as at 1986, the programme had a Rp 200-million credit turnover. A similar programme is also being carried out by TEHNOSA, a co-operative group under the umbrella of the Salman Mosque Foundation of the Bandung Institute of Technology.®

Only one form of the traditional interest-free financial institution which provides borrowing not only among customers but also among producers is the arisan system (rotating system), which involves rotation credit among members of the pool. In this system, each member contributes regularly a certain sum
and obtains funds from the pool by drawing lots. This practice is prevalent among craftsmen, small entrepreneurs and petty traders.⁹

**Development Of Islamic Banking In Indonesia**

Although the ideology of Pancasila becomes entrenched in Indonesian nationality, Indonesian Muslims are, however, with the existence of traditional Islamic educational systems such as *madrasah* and *pondok*¹⁰ as well as the system of *fatwa* (decrees), which are of a pure religious nature, observants in terms of religious, social and economic affairs. Since the early 1990s there have been signs of resurgence in the importance of Islam. There is a substantial retail demand for the Islamic financial services. At the national economy in the financial sector, the growing importance of Islam in economic sphere was most visible, when the Minister of finance of Indonesia requested the Jeddah-based Islamic Research and Training Institute of the Islamic Development Bank to help organize in Jakarta in September 1990 a seminar on Islamic Banking. Since the Government of Indonesia at that time was in the process of giving approval to the establishment of Islamic bank in the country, the seminar was meant to educate the officials of the banking and financial institution and financial and economic departments of the country as well as the bankers in the private sectors with respect to nature and practice of the concept of Islamic banking.¹¹

The first Shari'ah bank to have been established in Indonesia, PT Bank Muamalat Indonesia, Tbk, commonly known as Bank Muamalat, Indonesia (BMI), was established in November 1991, and commenced operation on 1st May 1992. The establishment of the Bank was initiated by the Indonesian Council of Ulama (MUI), supported by a group of entrepreneurs and Muslim intellectuals whose name listed in the 227 shareholders of the Bank. The tremendous response from the public has been demonstrated by the stocks buying reaching an amount of Rp 84 billion instant commitments on the date of signing the Act of Establishment, 1st November 1991. Furthermore, at the
Bogor Presidential Palace, an additional commitment of Rp 106,126,382 from West Java community in the public offering of Bank Muamalat had been raised as the initial capital. On 27th October 1994, only after two years of its operation, BMI has succeeded to become a Foreign Exchange Bank. As after eight years of its operation, BMI has established its position as the first Shari'ah Bank and made a landmark in the banking history in Indonesia.¹²

**Operations of BMI**

Operation of BMI can be studied under the followings:¹³

1. Banking operation: Customers' Deposits / Sources of Fund

The Bank accepts deposits from its customers through the following funding products.

a) *Wadi'ah* Demand Deposits or *Wadi'ah* Current Account

_Wadi'ah_ Demand Deposits or _Wadi'ah_ Current Accounts represents third party funds (or customers' deposits) consignment in the form of saving current account which can be either in local or foreign currencies and which can be drawn any time by using cheques and transfer account. The Bank will give the customers bonus from the bank’s business revenue based on Bank policy. Annual bonus for rupiah _wadi'ah_ demand deposits, as in the end of 1999, ranged from 0 per cent to 4 per cent, whereas annual bonus for foreign currency _wadi'ah_ demand deposits ranged from 0 percent to 2.5 per cent.

b) _Mudaraba_ Savings Deposits.

_Mudaraba_ savings deposits represent third party funds on which the customers receive pre-determined profit-sharing return, on the principles of _mudarabah_, from income derived by the Bank from the use of such funds. As in the end of 1999, annual profit-sharing rate of _mudaraba_ savings deposits
ranged from 2.79 percent to 6.42 percent. Mudaraba savings deposits constitute of the following products.

(i) Mudaraba Savings Accounts.

(ii) Ummat Savings Accounts.

It is a saving-investment, which can be withdrawn any time at any outlet or at Muamalat ATM. Customers will enjoy the revenue sharing derived from the Bank’s business revenue. The ummat saving customers can also receive the benefit of life insurance and opportunity to win the umrah prize.

(iii) Trendi Savings Account.

It is a special savings account for teenagers and students. Besides the accident insurance coverage, it offers special prizes for high ranked students and one year scholarship for 50 students.

(iv) Ukhuwah Savings Account.

It is a saving accounted conducted in co-operation with ‘Dompet Dhuafa Republic’, for the convenience in making regular and automatic payment of zakat, infaq, sadaqah in three choice of package: Rp 25,000, Rp 50,000, and Rp 100,000. This saving can also serve as an ATM, shopping at the discounted shop, and accident insurance coverage. There is no additional charge on card issuance and services fee.

(v) Haji Savings Account.

(vi) Arafah Savings Account.

These two savings accounts are specially designed for the hajj pilgrimage plan. The saving scheme will help customers in planning their hajj in accordance with their financial capability and its intended hajj date. With the protection of life insurance coverage, customers can perform their hajj
peacefully. By joining *arafah* savings they will have the chance to win the *umrah* prize available for three winners every year, or by collecting 100 points, simply by recommending new customers to join this saving scheme.

(vii) *Umrah Mudaraba* Savings Account, and

(viii) *Qurban Mudaraba* Savings Account.

These two saving investment accounts are designed for the customers to be able to observe *umrah* and *qurban* (animal sacrifice in Islam) when the amounts of saving and revenue from the use of such saving reached the expenditures needed for *umrah* and *qurban*.

c) *Mudaraba* Time Deposits.

It represents third party funds for specific periods, which cannot be withdrawn. The customers receive predetermined income derived by the Bank from the use of such funds. Deposits can be either in local or foreign currencies. As in 1999, annual profit-sharing rate for rupiah *mudarabah* time deposits ranged from 3.7 per cent to 14.04 per cent, whereas annual rate of profit sharing for foreign currency *mudarabah* time deposit ranged from 2.91 per cent to 6.51 per cent. BMI also introduced another type of a time deposit, *Fulinvest* Deposit, for individual investment with attractive revenue sharing package. Available in 1, 3, 6 or 12 month's period of deposit with the chance to win the *umrah* prize through drawings with a multifold of Rp 1, 000, 000. Life insurance coverage will be provided for customers with 6 or 12 months deposit period.

d) Pension funds

Recently, BMI has introduced new type of funding product called *Muamalat Financial Institution Pension Fund*. The membership of *Muamalat* Pension Fund can be participated by anyone with the minimum age of 18 years or with the status of married, and the maximum age is 50 years old. The
installment is very reasonable, which is Rp 20,000 per month and the payment can be automatically deducted from the Bank Muamalat account or can be transferred from other banks. The Muamalat Pension Fund is going to launch a new product called Wasiat Ummat, where the participant is covered by life insurance with the same amount as the beginning pension benefit projected if the participant death occurs before the pension period matured.


The Bank, for providing financing for customers' project or acquisition of asset, employs various modes of Shari'ah-based financing. However, for the BMI, in addition to financing modes based on murabahah (cost-plus), istisna' (manufacturing contract), salam (forward sale), mudarabah (profit-sharing), musharakah (partnership), ijarah muntahia bit tamlik or ijarah wa iqtina' (hire-purchase) and qard hasan (benevolent loan), the Bank also employs the following modes.14

(a) Mudaraba Muqayyadah / Reksadana (Restricted Financing / Mutual Fund). This is an agreement made between two parties: the bank, which provides the capital (sahib al-mal) and the customer (mudarib) who manages the specified project (productive and halal). The capital cannot be used for other than the agreed project. The profit arising is distributed according to agreed ratio.

(b) Al-Rahn (Islamic pawning or mortgage). The agreement to deliver the customer assets for a collateral to the bank. When the asset is gold, it will be physically saved by the bank, but for vehicles and houses (properly) the customers has only to give ownership certificate.

(c) Wakalah (Agency). An agreement made between an institution or a person and a party on carrying the responsibilities and privileges to conduct a transaction. All the responsibilities and rights carried out by the appointed party
have to represent the institution or a person. The appointed party may get profit or fee out of the agreed transaction, and

(d) *Hawalah*. An agreement to overtaking the customer rights and responsibilities of the bank from other customer (third party). The first party will ask the bank to fulfill the liabilities occurred either from the sale contract or from other transaction from the third party. When the liabilities are matured, the third party will pay back to the bank. The bank will get profit from the overtaking fee.

3. Banking operation: Other Services

The Bank also provides other banking services under various facilities, which are as follows:–

(i) Automatic Teller Machine (ATM). A 24-hour on line services which provide convenience for the customers in cash withdrawal, transfer account, balance checking, *zakat* and telephone bill payments.

(ii) Phone Banking. A 24-hour information service through telephone in obtaining products information, balance account and so on.

(iii) Payment Point. A service provided by the bank for the customer and non-customers in paying the telephone bill and *zakat*. This payment point service is available at any ATM or outlet of BMI.

(iv) Saudi Arabian Rial Moneychanger at the Hajj Embarkation. A service outlet for the *hajj* pilgrims to buy Indonesian rupiah at the time of arrival.

(v) *Zakat*, *Infaq* and *Sadaqah* (ZIS) Payment. A service for the convenience of Muslim community in making a payment of *zakat*, *infaq*, *Sadaqah* either to the Muamalat ZIS institution or other ZIS institutions working in co-operation with BMI.
(vi) Payroll. A service provided for the convenience of company or institution distributing the employee salary. Then the employees of various companies or institutions can make the withdrawal of their salary from BMI.

(vii) Letter of Credit (L / C). A service provided for the export-import entrepreneurs in carrying out their transaction by using a Letter of Credit (L / C). The L/C service provided by Bank Muamalat is under the Islamic principles.

(viii) Other services. Bank Muamalat also offers other general banking services, against fee, to the public such as transfer, collection, standing order, bank draft, bank references, tax payment, etc.

Performance of BMI

The overall performance of BMI may be characterized as a steady growth. Table 1 shows financial highlights of the BMI during the period between 1995 and 1999.

By December 1999, the amount of BMI's total assets was Rp 693.32 billion, increasing by 55.12 % from the total assets in 1998 which was Rp 446.94 billion. The growth was mainly caused by the increase of current accounts with Bank Indonesia, the Central Bank of Indonesia, drastically from Rp 47.60 billion to Rp 222.26 billion. Such current accounts in 1998 had a portion of 9.93 per cent, while in 1999 the account managed to reach 32.06 per cent of the total assets.\(^{16}\)

The financing account, in 1999, still dominated the total assets of BMI with the portion of 53 per cent. Yet this amount was still much smaller than it was in 1998 that managed to reach a portion of 71 per cent. It was no surprising because of the decrease of growth reaching 24.3 per cent from the former year (1998). Having not expanded, the financing amount decreased from Rp 462.09 billion in 1998 to Rp 432.06 billion in 1999.
Table 1: Financial Highlights

<table>
<thead>
<tr>
<th>Description</th>
<th>Financial Years (Rp Billions)</th>
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<tbody>
<tr>
<td>Total Assets</td>
<td>394.47</td>
</tr>
<tr>
<td>Total Customer Financing</td>
<td>288.64</td>
</tr>
<tr>
<td>Total Deposits or Third Party Funds</td>
<td>232.27</td>
</tr>
<tr>
<td>Total Equity</td>
<td>107.37</td>
</tr>
<tr>
<td>Total Paid-up Capital</td>
<td>101.11</td>
</tr>
<tr>
<td>Total Revenues</td>
<td>51.23</td>
</tr>
<tr>
<td>Operating Profit</td>
<td>7.57</td>
</tr>
<tr>
<td>Net Income Before Tax</td>
<td>7.02</td>
</tr>
<tr>
<td>Net Income After Tax</td>
<td>4.92</td>
</tr>
</tbody>
</table>


(a) Assets Growth

Besides caused by increasing current account, the asset enhancement was also contributed by placement with other banks from Rp 2.60 billion in 1998, the amount increased to Rp 2.98 billion in 1999. On the other hand investment in shares stock slightly decreased, from Rp 2.36 billion in 1998 to Rp 2.33 billion in 1999.
(b) Liabilities and Equity

The equity of BMI in 1999 was Rp 101.38 billion, increasing from the former year, which was Rp 39.34 billion. Yet the amount is not equal to the year 1997 amounting Rp 109 billion. On the other hand, the amount of total liabilities in 1999 was Rp 591.94 billion, increasing by Rp 184.34 billion or 45.23 per cent of the total liabilities of the former year reaching Rp 407.60 billion.

The third party fund, which was successfully accumulated along 1999 period was Rp 528.08 billion, reflecting an increase of Rp 136.16 billion or 34.78 % of the former year reaching Rp 391.92 billion. This amount exceeds the amount in 1997, when crisis arose, which was Rp 463.27 billion. This was caused by the increase of current account, savings deposit, and time deposits. Demand deposits increased by 17.77 per cent from Rp 68.01 billion in 1998 to Rp 80.09 billion in 1999. Mudaraba savings deposits increased by 44.48 percent from Rp 102.84 billion to Rp 148.58 billion, and mudaraba time deposits by 3.77 per cent from Rp 221.08 billion to Rp 229.42 billion over the same periods. The return of the third party fund to the Bank indicates the recovery of public trust and business partner to the performance of BMI after contracting in 1998 and when the conventional interest rate drastically increased.

(c) Operational Performance

Total income of the BMI in 1999 amounted to Rp 80.82 billion consisting margin income of profit-sharing of Rp 32.50 billion, other operating income Rp 11.35 billion and non–operating income Rp 36.97 billion. In comparison to the amount of Rp 143.50 billion in 1998, total income in 1999 decreased by Rp 62.68 billion or 43.68 per cent. This contraction was mainly due to the drastically decrease of profit from Rp 67.16 billion in 1998 to Rp 32.50 billion in 1999, besides the decrease of other operating income amounting to Rp 65.00 billion. In addition, during the period of 1999, BMI had to assume liability for other operating expenses amounting to Rp 53.40 billion. As a whole the
decrease was amounting to 70.96 per cent from the previous year (1998). However it was quite relieving that the decrease of this operational expense was much more than decrease of income. With this condition the BMI successfully secured income before zakat and taxation amounting to Rp 4.05 billion.17

Infrastructures and Strategies of Development

Ever since its inception, BMI has been continuously striving to improve its services to fulfill the Muslim community expectation as a viable alternative banking system. Up-to-date, BMI has carried out numerous activities, especially in improving the productive asset quality, boosting the financing volume, internal consolidation, strengthening quality and competence of its human resources, increasing capital and enlarging network to make it the first and best Shari'ah Bank. BMI has committed itself to the development of various banking infrastructure and strategies that can be studies under the following points: 18

(a) Group Investment Banking (IB) and Treasury Formation. As a new unit, IB is directed to promote ‘Universal Value’ of BMI. At the early stage, this unit focuses on the activity on the preparation of work infrastructure. Along 1999 this unit managed to gain the profit of Rp 9 billion of the total inter-bank transaction, which was dominated by the transaction of foreign exchange.

(b) Service Network. At present BMI has 9 branches offices, 2 sub-branches and 26 cash offices. Being able to lead in the competition era of Shari'ah banking in 2000, BMI will open 10 more new branch offices. Thus BMI will be available in 23 provinces of Indonesia. Besides, based on the evaluation in 1998, BMI also relocated some cash offices and enhanced the status of some cash offices to be sub-branch offices.

(c) Information Technology (IT). With a view to improve its services, BMI has further enhanced its banking system and network. In 1999 eleven
Automatic Teller Machine (ATM) units have been operated. In line with this, BMI has succeeded in implementing wireless communication technology for the ATM operation in remote areas. A plan has also been set to join the 'ATM Bersama' (co-operated or mutual ATM services facilities with other banks).

It is also programmed to provide debit card system supported by PoS (Point of Sale) System amounting to 55 units. This system is going to be placed in outlets such as BMT, BPRS, or merchant BMI partner. For center of information service, BMI is going to provide 16 MBC (Muamalat Business Center). The development is primarily focused in the areas, which have no BMI branches, cooperation with takaful insurance, Muhammadiyah, NU, Kadinda, or other organization.

BMI is the only private bank that accepts the deposit of hajj pilgrimage cost and the registration of hajj pilgrims with online services. For this necessity, the computer in head office of BMI is connected 'on-line' to integrated Hajj Computerization System (SISKOHAT) AT Religion Department. This service will be enhanced that all branch offices of BMI are able to access.

(d) Internal Audit Division. The strategic function of Internal Audit Division in helping to secure the properties of bank and public funds have been executed in a well planned, effective and efficient programme. This is followed by the implementation of the supervisory function to improve and keep the level of compliance in carrying out the management policy. The task of assisting the Board of Directors and Board of Commissioners has been conducted by formulating the work plan, execution as well as monitoring of the audit results.

Based on the requirements of Execution Standard of Internal Bank Audit Function (SPFAIB), quoted in the regulation of the Bank of Indonesia No. P6/PBI/1999 dated September 20, 1999, the Internal Audit Division has to prepare the Annual Work Plan and Budget.
Every six months the Supervisory Section submits realization reports of the Annual Work Plan and Budget as an evaluation reference and responsibility within six months period as well as strategy for the formulation of the next semester plan.

(e) Human Resources Development. The success of BMI is vehemently dependent upon the quality of its human resource. During 1999, various programmes and continuous education and training activities had been carried out for the human resources development. Nearly 10 percent of the employee's cost has been allocated for the purpose. Moreover, top management regeneration of internal origin has been successfully implemented. Preparing for the next cadres, BMI had conducted the Muamalat Officer Orientation Programme and Branch Manager Training Programme. Another successful plan is the establishment of the Workers Union of Bank Muamalat (SP-BMI) on February 12, 1999.

Recently there are 600 employees of the Bank Muamalat, composing 49 per cent aged under 30 years, 45 per cent between 35 and 40 years, and the rest belongs to the age of 41 years and above. Most of them are university graduates.

(f) Supporting Small Business Enterprises.

The fact speaks out for itself that decades of the conglomeration development have been failed in creating trickle down effects to the small business, cooperatives, as well as public community in general. Based on its mission and experience from the reality, BMI has consistently directed its assets development in financing expansion of the sector. This step has been conducted through cooperation with related institutions such as Bank Indonesia, Department of Finance, Department of Forestry and Farming, Department of Agriculture, Department of Cooperatives, Regional Authority and others.
During the year 1999, total financing amount distributed by BMI to this small business sector is as the following: Rp 43.23 billion for the Primary Cooperatives for Members (KKPA), Rp 23.49 billion for Cooperative Credits (KKOP), Rp 147.41 billion for Farmer Enterprise Credit (KUT) and Commercial Financing for the Small & Middle Businesses amounting to Rp 3.05 billion. This certainly helps in raising standard living of people and economic development.

Those strategic steps have been regarded sufficient enough considering the fact that within the last two years, BMI did not carry out any financing expansion due to the crisis, which melt down the national economy. Therefore in the year 2000, BMI would still be consistently putting large portion for the development of small business and cooperative. This in turn contributes to improve economic condition of the country.

*Crisis: The Problem or the Success of BMI*

The South-East Asian economic crisis has done much worse towards the Indonesian economy. Since the middle of 1997 until the middle of 1999, Indonesia experienced adverse economic conditions, which had been characterized by highly volatile foreign currency exchange rate and interest rate, less liquidity and extreme lack of public confidence in the country’s banking system, which have significantly affected the banking sector including the BMI’s operation.

There have been wild fluctuations in the currency value since July 1997. Mainly in the second half of 1997, the rupiah went up and down like a yo-yo, with the intra-day amplitudes in excess of 10 per cent, the result of economic and political uncertainties as much as the relative lack of liquidity. Substantial amounts must have been made in the first few months of the crisis. The rupiah had fluctuated from Rp 2,300 for one US dollar in early 1997, to over Rp 15,000 at the height of the crisis. At one point it stabilized at about Rp 9.000 for a US dollar.19 Also there is no accurate figure at the NPLs (Non-performing Loans) that have soared in Indonesia following the crisis. Even before the crisis, some
state-owned banks had accumulated NPLs ranging from 12 per cent to 30 per cent of total lending. The crisis also caused hyper inflationary rate reaching 77.6 per cent with the dropping of economic growth of -13.68 per cent.

A growing number of Indonesian banks were overwhelmed by substantial credit losses, while many of them were facing liquidity problems. The Indonesian government was pumping liquidity into the ailing banks. The government had also put a special vehicle called Indonesian Bank Restructuring Agency (IBRA), whose ambition is to rehabilitate ailing banks. Some of the sector's major names, including Bank Danamon, BDNI and BCA have already come under IBRA management. Moreover, most financial institutions are way beyond rehabilitation.

The adverse economic conditions had also caused declining prices in shares listed in the Indonesian Stock Exchange, tightening of available credit and reducing economic activity. The liquidation of several banks in Indonesia had also caused deterioration of public confidence in the banking system, putting more pressure on BMI's liquidity and operations. The economic conditions have affected the ability of customers to fulfill their obligations when they matured, thereby significantly increasing inherent risk on the BMI's earning asset portfolio.

The crisis has been around for more 2 years, the sign of economic recovery and stability could be seen in 1999. According to Statistic Central Bureau (BPS), the inflationary rate has decreased to be 2.01 per cent, whereas the economic growth is calculated to be positive at the level of 0.12 per cent, though if compared to Thailand and Korea, who experienced the same crisis at the same time, Indonesian economic recovery is left behind around one to one and a half year. This situation can be seen from the instability of rupiah value with a quite high volatility. Rupiah happened to reach Rp 6,800 per US dollar since the general election until after the presidential election. But it went down to Rp 7,300 per dollar in mid-December 1999. The value of exchange is higher
than the fair value of rupiah. In the same period there was the increase of swap premium to Rupiah from around 5 to 7 per cent. These two conditions show that the risk of instability towards Indonesian economy has increased.24

When conventional banks and financial institution collapsed due to the impact of currency-turned economic crisis and large negative spread of economic condition, BMI, although affected by the contagion, proved its resilience. Bank Muamalat’s Shari’ah system was not only able to stay firm and be resistant against economic crisis, causing the collapse of other banks, but also generated profit, although economic recovery and banking situation have not been running well yet. The excellence about the Islamic banking has already been proven during this crisis in South-East Asia, especially in Indonesia. When all the conventional banks were in trouble and most of them underwent treatment having been put in the IRBA, BMI was free from loss caused by negative spread of economic condition. The third party funds or consumers’ deposits, which happened to decrease when the conventional bank’s interest rates sharply increased in 1998, has been return to BMI. This amount was higher than those of the 1997, during the crisis. Apparently people regard that Islamic system of banking is able to be the alternative to save the economic condition.

The realization of the Shari’ah system is now being followed by several conventional banks, either as a full Shari’ah branch or as an Islamic window. Lessons learned from the crisis, a new knowledge has opened the eyes of public and the issuance of the Acts No. 10/1998 on banking have substantiated the role of the Shari’ah bank in the Indonesian Banking industry. The issue of the Acts provides more opportunity for the expansion of Shari’ah banking institutions and departments in the country.25 The setting up of the second Islamic bank in 1999, Bank Mandiri Syari’ah, provided an example for such liberalization.
Prospects and Business Risk

In general, banking prospect in the near future has yet to wait for an ideal condition. Banking growth was estimated to face a slow down due to decrease in profitability, huge amount of non-performing loans, low level of credit distribution and the slow banking restructuring and recovery process conducted by the government.

One positive factor influencing the banking recovery process in Indonesia is the upcoming trend of positive economic growth and the decline of the interest rate. The rolling of economic wheels would further enhance improvements in the banking credit quality an would definitely decrease the obligation to provide allocation for depreciation, strengthen the capital and boost further improvement in profitability.

Strategic Plans

In the year 2000, BMI anticipated to raise capital through the issue of certificates based on Shariah, which was expected to reach Rp 50 billion. It would be the second phase in which the first one was carried out in 1999. The growth of productive assets would be directed to:

(i) increase collective financing by decreasing the financing of problematic portfolio intensively;

(ii) maintain the financing collectibility by precise customer monitoring on their payment and prospect;

(iii) take steps to anticipate problematic customers by portfolio identification and evaluation as well as early alternative prevention; and

(iv) improve documentation, administration and legal financing.
With great precaution, BMI in 2000-2001 would start expansion, taking care of excess liquidity and the high business risk. The growth of assets would focus on the small-scale businesses and the medium ones having indirect agricultural sector (off-farm), plantations, forestry, trading sector of those products as the target.

Besides commercial financing, activity expansion for small-scale business is targeted to credit programmes. There are some programmes being developed on this segment, related to Shari’ah Banking. They are developing BPRS, PPRS-BMT and Kopontren.

The scheme on credit programme distribution is the Shari’ah Primary Credit Cooperatives for Members (KKPA), which is a cooperation of BMI with PT Permodalan Nasional Madani (PNM) implementing profit-sharing system. The amount of funding was Rp 40-50 billion in 1999-2000 sharing with BPRS, BMT and Kopontren. Credits are also given to cooperative (Kkop) amounting to Rp 50-60 billion in 2000-2001.

The other project carried out by BMI is P2KER (People's Economic Empowerment Project) to distribute the funds to 700 units savings accounts in 15 provinces.

Those strategic steps taken are regarded as sufficient, considering that BMI has not been able to expand due to the economic crisis. Meanwhile the expansion of funding for middle-class business will be targeted to facilitate business between regions and countries based on agricultural commodities and small-scale industries based on the strategy above, the company's expansion has been expected to grow around 20-25 per cent, consistently. To support the expansion, wide service network especially in the strategic places, is the prerequisite of the further development of the company.
Vision and Mission of BMI

With the help of business prospect and infrastructural and strategies of development, BMI has summed up the following bank’s vision and mission.28

1. Vision 2005

The vision of 2005 of BMI will be:

(a) the premier Shari’ah Bank in Indonesia;

(b) the dominant player in the ‘emotional’ Shari’ah market; and

(c) the most admired bank in the ‘rational’ market.

2. Mission

The bank’s mission will be:

(a) to become a professionally–run Shari’ah Bank emphasizing management excellence, market orientation, and entrepreneurial spirit;

(b) to become the Islamic Bank role-model; and

(c) to become the most innovative niche investment-oriented bank.

Unlike Malaysia, which has quite big number of Islamic banking players, BMI enjoys, to great extend, a monopoly in the field of Islamic banking provider and respectable reputation as the best Shari’ah Bank in Indonesia. Public's confidence of the Bank during and post-crisis will only add up its influence. The challenge rather than problem, of the BMI is its vision, mission, and strategies of development.
BRUNEI DARUSSALAM

The tiny oil-rich Sultanate of Brunei is small with a population of about 300,000 people in which Muslims constitute around 70 per cent of which 95 per cent are Malays. The tiniest kingdom on earth is ruled by Sultan Hassanal Bolkiah, one of the world’s top ranked richest men. Much of Brunei’s income and wealth is generated by the petroleum sector, owned by the royalty, while people are engaged in traditional activities such as farming and fishery, and more recently in commerce and trade. Manufacturing is a new phenomenon in Brunei Darussalam. Private sector in non-oil sector is relatively free from government intervention.

Islamic Banking And Finance In Brunei

As the official religion, Islam is given state patronage. In Brunei, the development of Islamic banking, although late organized, is gaining significance. Brunei has set up its first Islamic bank in 1993 in Bandar Seri Begawan, the capital of Brunei, to inject religious tenets into the financial administration of the country. The Islamic Bank of Brunei Berhad (IBB) was officially launched on 13th January 1993 by the Sultan Hassanal Bolkiah. Realizing the universal concept of Islamic financial system, the Sultan addressed “the Islamic financial system is aimed at looking after the welfare of all mankind, irrespective of their race and religion.”

The second Islamic financial institution, Tabung Amanah Islam Brunei (TAIB) has also been set up recently. Since all of the operation, performance, and experience of both the IBB and TAIB are to great extent similar to that of the Malaysia and Indonesia, there is, thus, no need to go in such a detail.

Being a Muslim dominated country at royal and local levels whose Sultan and people are longing for permissible system of banking and finance coupled with the royal patronage and wealth that has been accumulated by the
population of Brunei with per capita GDP estimated currently at US$ 20,100,\textsuperscript{32} the current position and future prospect of Islamic banking and finance in Brunei is considerably promising. This is obviously true in the sense that the Sultan of Brunei announced on his 54\textsuperscript{th} birthday, July 15, 2000, that “Brunei had decided to build the financial center to turn the nation-state into a regional financial hub, providing employment opportunities as well as attracting new skills and technology. Although the conventional products, such as insurance, will form the core, the center is hoped to attract Muslims from Malaysia, Indonesia, West Sudan, Turkey, and Morocco. As Muslims become more and more devout, there is increasing demand for Islamic paper and money market instruments and there are not enough of these instruments”, quoted Selamat Munap, Deputy Financial Minister of Brunei.\textsuperscript{33}

Having discussed Islamic banking and financial activities in all Muslim-majority countries in South-East Asia, we may rightly say that Malaysia, Indonesia, and Brunei in which Malay is the core constituent of Muslim population the roots of Islamic banking and finance have firmly established. In spite of slightly different in their set up, the dual-banking system of Malaysia, a relatively monopoly-enjoyed status of Shari'ah bank of Indonesia, and the Sultan-patronized Islamic Bank of Brunei show the same direction: innovation in banking and finance on Islamic lines.

NOTES&REFERENCES


2. Pancasila incorporates five basic principles which are (1) belief in the One Supreme God, (2) just and civilized humanity, (3) the unity of Indonesia, (4) democracy by the wisdom of deliberations among
representatives, and (5) social justice for all the people of Indonesia. It is the state that further defines these principles and translates them into action. For more insights on the Pancasila Idea in Indonesia and related issues, see Anshari, Saifuddin, "The Jakarta Charter 1945", Kuala Lumpur, Muslim Youth Movement of Malaysia, 1979, pp. 10-17.


4. Ibid, pp. 74-75.

5. Hatta, Muhammad, "Kedudukan Bank Dalam Masyarakat" [The place of a bank in society], in Beberapa Fasal Ekonomi [Some economic Passages], Jakarta, Dinar Penerbitan Balai Pustaka, Vol. 2, 1958, pp. 28-47. Hatta was a foreign trained economist and the most prolific writer on this topic to date. Besides his role as freedom fighter and statesman after independence, he is honoured as the Proclamator of Independence and the first Vice-President of the Republic of Indonesia. No less than fifteen articles, short and long, were produced by him, extensively discussing topics to do with money, bank credit, and the question of interest, all of which are compiled in his book Beberapa Fasal Ekonomi indicating his vast and technical knowledge of banking and its operations.


10. See reference no. 8 in Chapter 3.


15. Ibid, p. 49.

16. This, obviously, refers to part of the Central Bank Policy, Bank Indonesia, in the period of the economic crisis or financial crisis, by imposing higher statutory requirement. As also seen by the fact that the Capital Adequacy Ratio (CAR) was 14.09 percent in 1999, which was double of the former year that was only 6.76 percent. This higher current deposit with the central bank may also reflect the immense availability of BMI excess idle liquidity due to lower financing opportunity during recession.


22. Delhaise, Philippe, op.cit., p. 139.

24. Ibid.


27. Ibid, pp. 31-32.

28. Ibid, p. 3.


