UNDERSTANDING ISLAMIC COOPERATIVES MECHANISMS FOR THE ACCESSIBILITY PROMOTION OF ISLAMIC FINANCE IN MALAYSIA

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Abstract

Islamic finance industry has grown rapidly and recognized not only to the Muslims but also attracted non-Muslim to use it. However, Islamic finance industry is dominated by the Islamic banking and Takaful and Islamic capital and money market. The participation of non-bank financial institutions such as Islamic cooperative and Islamic microfinance in Islamic finance is still limited compare to the customers of these institutions. The participation of Islamic non-bank financial institutions is expected to increase the contribution of Islamic finance and competition with conventional finance.

Keywords: Islamic Cooperative, Islamic Finance, Non-bank Financial Institutions

INTRODUCTION

Islamic finance industry has grown rapidly, since it first emerged in the 1970's. Islamic finance that offers interest-free banking and Islamic financial services has attracted more than 1.6 billion Muslims across the world. Now, there are over 300 Islamic financial institutions worldwide across 75 countries including the United States. According to the Asian Banker Research Group, The World's 100 largest Islamic banks have set an annual asset growth rate of 26.7 percent and the global Islamic Finance industry is experiencing average growth of 15 percent to 20 percent annually (The World Islamic Banking Competitiveness Report 2007 - 08). In 2011, Islamic banking assets with commercial banks globally grew to US$1.3 trillion, with an average annual growth of 19 percent over past four years (Ernst & Young, 2012). Islamic banking assets have grown beyond the targeted 20% as intended in Bank Negara Malaysia’s Financial Sector Masterplan. The total Islamic banking assets is 27 percent of the total banking system (BNM, 2016)
In Malaysia, Islamic finance industry has been in existence for over 30 years where the first Islamic financial institution is the Malaysian Pilgrims Fund Board in 1963. In 1983, the first Islamic bank, Bank Islam Malaysia Berhad (BIMB) has started their operations on the first of July 1983. In 2011, the Islamic banking industry has grown rapidly whereby the number of Islamic banks have increased to 36 financial institutions consisting sixteen full-fledged Islamic banks, five international Islamic bank, seven investment banks, two commercial banks offering Islamic banking and six development financial institutions offering Islamic products and services (BNM, 2011).

Besides, there are eight Takaful operators for family and general Takaful business, three Takaful operators for family Takaful business, four retakaful companies which consist of three retakaful operators for family and general retakaful business and one retakaful operator for general retakaful business (BNM, 2016). This increase is expected to contribute to Malaysia Gross Domestic Product (GDP) where it is expected to grow 6 times of GDP in 2020 from 4.3 times of GDP currently in 2011 (BNM, 2012). Meanwhile, total contribution of the financial services sector to nominal GDP is expected to grow from 8.6 percent of nominal GDP to between 10 percent and 12 percent by 2020.

However, there is a gap in the growth of Islamic finance industry that caters the need of third economic sector that includes Small-Medium enterprises (SMEs) and the community that otherwise could not have the access to Islamic finance. Conventional mechanisms such as micro finance and micro insurance in enhancing financial inclusion to the poor have been partially successful. However, financial inclusion using Islamic finance product for the poor are still not fully overcome (Zamir Iqbal & Abbas Mirakhor, 2012). Therefore, to enhance Islamic finance contribution to Malaysia’s GDP, the development of non-bank Islamic financial institutions is needed to increase the access of Islamic finance to the community. This is because the limitation as to areas of Islamic banks and Takaful institutions may contribute. The establishment of Islamic cooperative model could be used by 9074 cooperatives already exist in Malaysia. This will increase the access of Islamic finance to 7.04 million existing members of cooperatives, who are farmers, low-middle income government servants, and those who need financial enhancement.

The contribution of these cooperatives was 23.09 billion (92.8 billion of assets) in 2011 which shows significant potential of Shariah-compliant funds that could be further mobilized to increase the size of Islamic capital market (ICM). At current, ICM’s development is concentrated in the traditional sector which is shares and Sukuk. With 89 percent of counters in Bursa Malaysia are Shariah-compliant and Malaysia as the lead for Sukuk issuance, the
said instruments are now facing saturation. Whilst, for the cooperative sector, little initiatives are taken to mobilize the existing sector to be developed under the umbrella of Islamic finance.

In terms of asset management, Malaysia already has the largest number of Islamic funds in the world with 184 funds, and the second largest value of assets under the management of RM18.2 billion (Pemandu, 2012). Nevertheless, Pemandu (2012) laments that the sector lacks of scale. In the long run, Malaysia could be the global Islamic asset management product innovation via the development of the Islamic cooperative as it is a non-traditional financial sector that has a great potential to be absorbed into the Islamic finance industry.

It has been proven that in most countries, SMEs play as a backbone of the economic development and as a major source of employment and income. In Malaysia, SMEs accounted for 97.3 percent of total business establishments and contributed to gross output around 28.5 percent and to value added around 30.2 percent in 2010 (Department of Statistics, 2012). In terms of employment, SMEs contributed around 52.7 percent of total employment in 2010 (Department of Statistic, 2012).

However, the most challenges faced by SMEs are to get financing for their businesses, though it is one of the primary contributing sectors to the GDP growth even in developed countries like Germany and the US (Cotler & Woodruff, 2008; Mel et al., 2007). Most of the SMEs receive funds from their own sources and borrowing from family and friends (Department of Statistics, 2012). The limited sources of funds from the banking industry to support SME development call for other alternative financing. Therefore, the introduction of community or cooperative banks can ensure the funds generated within the community will stay within the community.

THE HISTORY, DEFINITION AND THE OPERATIONS OF COOPERATIVES AND ISLAMIC COOPERATIVE

The history of cooperative begins in 1844 in Britain to solve the poverty problem that arises because of unfairly distribution of resources and the rise of price of goods. The first cooperative formed is the Rochdale Equitable Pioneers and then the cooperative movement expands into other countries across the continent including South East Asia with the involvement in various sectors of the economy. The growing need for credit and access to the basic necessities of life and business led to the formation of most of the cooperatives in the world. A cooperative formed when at least two persons who have common problems joined
Cooperative can be defined as a voluntary association of people, engaging in a democratically controlled business organization, operating at cost which is owned, capitalized and controlled by patrons as users, sharing risks and benefits in proportion to their participation to achieve a common economic goal (Kareem et al., 2012). The establishment of cooperative is important to help the members to obtain credit in an easy way unlike in the banking sector that need collateral requirement and complicated documents.

Cooperative is a firm owned, controlled and operated by a group of people for their own benefit where each member contributes equity capital, and each member has one-vote principle. Cooperative model is much like associations and community banks except that it ownership structure does not include the poor (Fehmeen, 2010). These institutions are owned and controlled by their members. They function according to democratic rules and government rules where profits are reinvested or shared among members. Cooperatives are registered under a country’s cooperative law or are included as a special category in the banking law. Lapenu and Zeller (2001) estimated that the cooperative model provides about 60 percent of savings and 59.9 percent of loans to the members. The major advantage of these institutions is their ability to serve large numbers of clients in urban and rural centers.

Cooperatives are community-based, rooted in democracy, flexible, and have participatory involvement, which makes them well suited for economic development (Gertler, 2001). The process of developing and sustaining a cooperative involves the processes of developing and promoting community spirit, identity and social organization as cooperatives play an increasingly important role worldwide in poverty reduction, facilitating job creation, economic growth and social development (Gibson, 2005). In addition, cooperatives are being considered useful mechanisms to manage risk for members and keep markets efficient (Henehan, 1997). Nweze (2003) suggests increasing agricultural productivity and to enhance the economic and social status of farmers is through cooperative membership.

Cooperatives differ widely in constitution, aspirations, and business organization. With regards to organizational form and objectives, cooperatives may show as much variation as we find between cooperatives and private companies (Soboh et al., 2009). Table 1 shows the differences between cooperatives and private companies (investor owned firms).
Table 1: Comparative between Cooperatives and Private Firms

<table>
<thead>
<tr>
<th>Cooperatives</th>
<th>Private firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provide services for members</td>
<td>Maximization of shareholder’s wealth</td>
</tr>
<tr>
<td>Democratic rule, one member one vote</td>
<td>Vote is based on the total share owned</td>
</tr>
<tr>
<td>The board of directors are appointed among members in the AGM</td>
<td>The board of directors are appointed and determined by the major shareholders</td>
</tr>
<tr>
<td>User-owner</td>
<td>The owner and the clients are different</td>
</tr>
<tr>
<td>Benefit to members</td>
<td>Benefit to shareholders</td>
</tr>
<tr>
<td>Dividends are limited on capital and priority is given to subscriptions.</td>
<td>Dividends are based on shares owned</td>
</tr>
</tbody>
</table>

Source: Cooperative Commission Malaysia, 2009

Islamic cooperative is a conversion of conventional cooperative through an approach that is in line with Shariah. The establishment of Islamic cooperative is basically using the concept of Shirkah Mufawadah in which all parties involved contribute fund in the same portion as well as equally participate in managing the organization and the profit and loss are shared among the members. In the practice of cooperatives, no one is allowed to inject bigger amount of fund and receive bigger portion of profit as compared to the others (Kospin Jasa Syariah, 2009). Basic principle of Islamic cooperative is on strong cooperation among members. Members’ annual meeting is the highest ‘shuratic’ forum in which all strategic decisions are made. Each member has equal vote and opportunity to express idea and opinion (Irfan Beik & Indah Purnamasari, 2011).

There are six major characteristics of Islamic cooperative; 1) acknowledging member’s ownership right on business capital; 2) no riba-based transactions are allowed; 3) institution of ZISWAF (zakat, infaq, sadaqah and wakaf) is functioning well; 4) admitting profit-oriented motive as long as Shariah principles are strictly followed; 5) acknowledging freedom of business and economic endeavors and; 6) acknowledging common rights (Buchori, 2009). Table 2 shows the comparison between Islamic cooperative and conventional cooperative.
Table 2: The Comparison between Islamic Cooperative and Conventional Cooperative

<table>
<thead>
<tr>
<th>Islamic Cooperative</th>
<th>Conventional Cooperative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Driven by profit and social motives.</td>
<td>Relies more on profit motive.</td>
</tr>
<tr>
<td>The operation is based on Shariah and legal rules prevailing in the countries.</td>
<td>The operation is based on legal rules only.</td>
</tr>
<tr>
<td>The profit earned from various Islamic modes of financing.</td>
<td>The profit earned from interest levied.</td>
</tr>
</tbody>
</table>

Source: Irfan Beik & Purnamasari (2011)

COOPERATIVE DEVELOPMENT IN MALAYSIA

In Malaysia, the cooperative was introduced to solve the problem of rural farmers suppressed by middlemen under kunca rice system and indebtedness problem of civil servants in the city. In 2002, the government issued a special policy that maps the direction of the cooperative where the National Cooperative Policy 2002 – 2010 was introduced. This policy outlines implementation strategies to enable the cooperative movement to take a more active role in the economic development together with public and private sector. Under this Policy, the authoritative streamlined accountability structure in which all types of cooperative have been placed under Cooperative Commission of Malaysia (SKM). Previously, Farmers Organization Authority (LPP) monitors agriculture cooperatives and Fisheries Development Authority Malaysia (LKIM) monitors fishery cooperatives. Since then, the number of cooperatives including Islamic cooperatives increased from year to year by an average of 9.4 percent (Cooperative Commission Malaysia, 2009).

Table 3 shows the development of cooperative and its membership, share capital, asset value and earnings from 2005 to 2014.

Table 3: Cooperative Development, Membership, Share Capital, Asset Value and Earnings (2005 to 2014)

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Cooperative</th>
<th>Membership (in millions)</th>
<th>Share Capital (RM billion)</th>
<th>Asset (RM billion)</th>
<th>Earnings (RM billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>4,771</td>
<td>5.69</td>
<td>6.85</td>
<td>34.87</td>
<td>4.60</td>
</tr>
<tr>
<td>2006</td>
<td>4,918</td>
<td>5.87</td>
<td>7.29</td>
<td>37.47</td>
<td>5.10</td>
</tr>
<tr>
<td>2007</td>
<td>5,170</td>
<td>6.32</td>
<td>7.79</td>
<td>47.40</td>
<td>6.10</td>
</tr>
<tr>
<td>2008</td>
<td>6,084</td>
<td>6.51</td>
<td>8.42</td>
<td>55.73</td>
<td>7.75</td>
</tr>
<tr>
<td>2009</td>
<td>7,215</td>
<td>6.78</td>
<td>8.97</td>
<td>65.00</td>
<td>8.92</td>
</tr>
<tr>
<td>2010</td>
<td>8,146</td>
<td>6.60</td>
<td>9.55</td>
<td>71.78</td>
<td>9.53</td>
</tr>
<tr>
<td>2011</td>
<td>9,074</td>
<td>7.04</td>
<td>10.49</td>
<td>92.80</td>
<td>23.09</td>
</tr>
</tbody>
</table>
The government expects cooperatives to be the third engine of growth besides public and private sector. Commitment and confidence placed by the government are reflected by the financial and non-financial support indicated in various development plans. Prior to the Fourth Malaysia Plan there was no clear policy on cooperative. The National Cooperative Policy (NCP), 2002-2010, was launched in 2002 to provide the orderly re-development of cooperatives. This is the first national policy on cooperative development since independence. The short-term objective of the policy is to enhance the understanding of cooperative ideology amongst the people, so that the cooperative can function as organizations that can contribute towards economic growth and social development. Its long-term objective is to transform the cooperative movement into a vehicle that is competitive and geared towards eradication of poverty, creation of employment and business opportunities and upgrading of quality of life, based on the cooperative principles, for the national development in line with Vision 2020. In the National Cooperative Policy 2011-2020, the cooperative is expected to contribute five percent to GDP in 2013 and ten percent to GDP in 2020.

The strength of the cooperative movements is currently in the services sector where the services sector contributes 62 percent of the total earnings or income of all cooperatives in Malaysia in 2014. This largest contribution of earnings is generated by 577 banking and credit cooperatives which represents 8 percent of the total registered cooperatives with estimated total earnings amounting RM5.71 million. The highest earning contribution is from the Bank Kerjasama Rakyat Malaysia (Bank Rakyat). Bank Rakyat is the biggest Islamic cooperative bank in Malaysia with assets totaling RM79.21 billion as at end of 2012 (Bank Rakyat, 2012). Table 4 presents the number of cooperatives by activities in 2014.

**Table 4: Number of cooperatives by activities as at 31 December 2014**

<table>
<thead>
<tr>
<th>No.</th>
<th>Activities</th>
<th>Number of Cooperative</th>
<th>Membership</th>
<th>Fees/Share Capital (RM billion)</th>
<th>Asset (RM billion)</th>
<th>Earnings (RM billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Banking</td>
<td>2</td>
<td>993,593</td>
<td>3,316.28</td>
<td>90,632.63</td>
<td>6,093.65</td>
</tr>
<tr>
<td>2</td>
<td>Credit/Finance</td>
<td>597</td>
<td>1,338,057</td>
<td>5,606.84</td>
<td>11,945.73</td>
<td>1,878.66</td>
</tr>
</tbody>
</table>

Source: Cooperative Commission Malaysia, 2015
3 Agriculture   2,553  744,863  604.86  2,449.65  2,823.13  
4 Housing       217   154,944  218.42  1,032.35  530.45   
5 Industrial    253   18,155  11.04   78.77   35.97   
6 Consumer      
   -Adult       2,609  607,967  312.15  1,369.22  804.85   
   -School      2,307  2,140,193 23.72   284.75   321.90  
7 Construction  196   130,614  59.61   414.23   87.47   
8 Transportation 460   149,273  67.18   323.30   700.67  
9 Services      2,677  1,131,888 3,247.96 8,257.06  21,674.21  

11,871  7,409,547 13,468.06 116,787.70 34,950.98

Source: Cooperative Commission Malaysia, 2015

In 1971, the Malaysian National Co-Operative Movement (ANGKASA) was established under the Co-Operative Societies Ordinance 1948 to unite all co-operatives within one comprehensive movement. As at December 2013, it has current membership totaled 5413 co-operatives with 16 state liaison offices nationwide (ANGKASA, 2014). The roles and functions of ANGKASA are:

i. to unite and represent co-operatives in Malaysia at the national and international levels

ii. to stimulate and develop co-operatives’ business by identifying new business areas, developing and strengthening existing business and creating national and international networks

iii. to increase understanding and practices of pure co-operatives’ values and principles align with ILO Recommendation 193 which recognizes co-operatives as a tool for economic and social development of the community

Then in 2011, the Cooperative Commission Malaysia was approved by the registration of KOPSYA ANGKASA, the Islamic Cooperative Bank that provides Islamic banking services to its members. The vision of KOPSYA is a national secondary financial cooperative that drives the development of the cooperative movement and country. The products offered by KOPSYA include project financing (Al-Tijari), pawn broking (Al-Rahn), home financing (Musyarakah Mutanaqisah), deposit (Al-Tawreed), and personal financing (Al- Tawarruq). Meanwhile, the source of funds come from members saving’s accounts, investment accounts, Musharakah program with cooperatives, financial institutions, investment institutions and the market shares or fees and other sources such as financial institutions and the government. As at September 2013, KOPSYA has a membership totaled 478 as shown in table 5.
Table 5: Number of KOPSYA membership by activities as at April 2014

<table>
<thead>
<tr>
<th>Activities</th>
<th>Total Cooperatives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit</td>
<td>129</td>
</tr>
<tr>
<td>Consumer – Adult</td>
<td>104</td>
</tr>
<tr>
<td>Consumer – School</td>
<td>61</td>
</tr>
<tr>
<td>Agriculture</td>
<td>71</td>
</tr>
<tr>
<td>Housing</td>
<td>24</td>
</tr>
<tr>
<td>Services</td>
<td>99</td>
</tr>
<tr>
<td>Transportation</td>
<td>24</td>
</tr>
<tr>
<td>Industrial</td>
<td>5</td>
</tr>
<tr>
<td>Construction</td>
<td>7</td>
</tr>
<tr>
<td>Total</td>
<td>524</td>
</tr>
</tbody>
</table>

Source: Syed Mohd Ghazali Wafa, 2014

DEVELOPING COMMUNITY-BASED FINANCE VIA COOPERATIVE

As cooperatives are community-based and involve participation of the members, it is timely to enhance the role of cooperative in Islamic finance to achieve the economic objectives of the society. Islamic finance industry is yet to prove to the community that it enhances the quality of life of the society as well as championing the cause of the society. Zaman (2013) highlighted that Islamic finance could achieve the sought-after equity participation through cooperative. This is by the engagement of Islamic finance to provide service-based provisions to the community. He pointed out that Islamic banks were away from assuming risks in the real production and provisions of services, resulting to minimal production of such products and services, and involve only in mark-up products such as murabahah. He highlighted the success of service-based provisions such as the service of hajj management in Malaysia by Tabung Haji. Large population of Muslims makes it possible for such service-based provisions are feasible to the Islamic finance industry.

He highlighted some areas where Islamic finance could be developed focusing on the service-based provisions such as:

i. Tabung Haji: Accumulate for Hajj
ii. Building Societies. Accumulate for House
iii. Transport Societies: Accumulate for Vehicle
iv. Educational Societies: For future
Since these services are all social needs, it makes sense that the members are paying since they are part of the society. The challenges to move to the next development of Islamic finance that focuses on the societal involvement are equitable and participatory are highlighted by Zaman (2013). He highlighted that there is a need to develop new breed of bankers as the current generation does not have training to enter real world applications. He put forward the case of micro-finance and agricultural loans application in many countries such as in Pakistan and Indonesia. Evidence in Pakistan showed that money lenders in Pakistan are successful in both micro-finance and agricultural loans, while bankers failed at both, due to lack of required knowledge, experience and training.

In Malaysia, the New Economic Model (NEM) promotes inclusiveness by the way of reducing the inequity divide for the haves and have-nots. For that to happen, an economic transformation is needed to promote equality. It has been proven that in most countries 60-80 percent of the GDP growth is achieved by Small and Medium Enterprises (SMEs) and the similar portion of job growths come from this sector. Figure 1 depicts the areas in Islamic finance that are critical to be studied to steer the development of Islamic cooperatives.

![Diagram](Figure 1: Critical Areas of Development in Islamic Cooperative)

Therefore, researches are concentrating on the following areas to understand the feasibility of adopting Islamic finance in developing Islamic cooperative model. It needs to examine:

i. The suitability of adoption of Islamic finance in a cooperative setting

ii. The applicability of the conventional performance measurement measures for Islamic cooperative
iii. The applicability of conventional cooperative members monitoring measures for Islamic cooperative

Studies could also be conducted to explore the use of distinctive partnership contracts such as the muzaraah/mukhabarah (share cropping), mugharasah (share planting) and musaqaah/muamalah (share watering) that are specifically developed for agriculture sector. These contracts are applied especially in Madinah during the reign of the Prophet (pbuh) and companions as the sources of financing to agricultural activities. Looking at their potential and the suitability of the area of studies, these contracts will become the underlying structure for the proposed cooperative financing products. Hutchinson and Campbell (1998) suggest that there is a consensus around a number of defining partnership: partnerships bring together a coalition of interests drawn from more than one sector to generate agreement; partnerships have common aims and strategies to achieve them; partnerships share risks, resources and skills; partnerships achieve mutual benefits and synergies.

In addition, focus group study is needed to enquire on the feasibility of developing the Islamic cooperative among Shariah scholars for product development and top management of cooperatives to learn on how cooperatives could be mobilized as an Islamic finance instrument. This includes performance and monitoring measures development, considering the success and setbacks of micro-finance and other community-based finance performance such as a programme offered by the Institute for Research and Community Development Tazkia, i.e. Tazkia Microfinance Centre (TMFC). Besides, questionnaires and surveys can be distributed to the members of cooperatives to learn about the background of the members to identify the expectation for Islamic cooperative.

Having Islamic cooperatives is one of the ways for Malaysia to become an Islamic financial hub. This is because it will boost the funds under management and also the number of individuals having access to Islamic finance.

**CONCLUSIONS**

The involvement of Islamic cooperative in Islamic finance could strengthen its position in providing Islamic financial services where previously only the Islamic banking and Takaful sectors dominating the industry. The involvement of non-bank financial institutions is important to ensure the inclusion of Islamic finance to all communities including the poor and low-income group. In addition, Malaysia intends to bring the cooperative into the mainstream development of financial services through Cooperative National Policy 2011-2020.
Therefore, the involvement of Islamic cooperative will enhance the development of cooperative in Malaysia.

REFERENCES


