

Sharing Economy of Islamic Microfinance & Its Impact on Social & Financial Inclusion: Social Capital Matter?

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The significant role of Islamic microfinance is how they could articulate the collaborative nature of Islamic moral economy in the form ukhuwwah (social capital) among the poor participants' program. Sharing or collaborative economy in this business platform is how poor participants of Islamic microfinance-group lending model (GLM) based, which considered as unbankable or even un-bmtable share they risk, having mutual trust, cooperative, collective responsibility to have an access to social as well as financial services provided by any form of philanthropy aids. The existence of ukhuwwah (social capital) would become critical informal institutional values that leads to an efficient sharing or collaborative business among the poor participants. The aims of the paper is to highlight the effectiveness of Islamic microfinance-group lending model (GLM) based in Cooperative Empowerment of Baitut Tamkin Tazkia Madani (BTTM) to establish social capital in supporting sharing economy and hence promoting the achievement of social and financial inclusion of the poor participants. Therefore, any kinds of philanthropy for humanitarian aid (including ZISWAH) should pay critical attention to the existence of social capital in order to alleviate poverty as well as to maintain human dignity.

Keywords: Islamic Microfinance; Sharing Economy; Social Capital; Social & Financial Inclusion.

OPEN ACCESS

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Received: 17 February 2023
Accepted: 20 February 2023
Published: 18 March 2023

Citation:
(2023) Sharing Economy of Islamic
Microfinance & Its Impact on Social
& Financial Inclusion: Social Capital
Matter?
Tamkin Journal
2.1.

INTRODUCTION

Over the last two decades, the concept of social capital has gained an increasing attention across a wide array of disciplines and has engendered considerable research and debate in both political and social science arena (Magson, et. al., 2014). This particular concept has been used at several levels in microfinance literature. It is well established opinion in finance theory that credit markets characterized by high asymmetric information, notably, the existence of moral hazard and adverse selection problems, leads to severe distortion and sometimes complete collapse of the formal credit market (Akerlof, 1970. Daripa, 2000. Dusuki, 2008). Financial contracts will not be written under this condition. Hence, goods and services will be under-produced and under-consumed. The contracts between borrower and lender will only be honored if the element of trust exists in such transactions. It is in this context, Commercial banks distrust poor people for credit because they cannot enforce repayments without a presence of loan collateral. Informational problems arise as banks fail to distinguish 'good' among 'bad' borrowers, due to the poor lacking accounting report of their business. Poor people have no "power" to play and compete within the market.

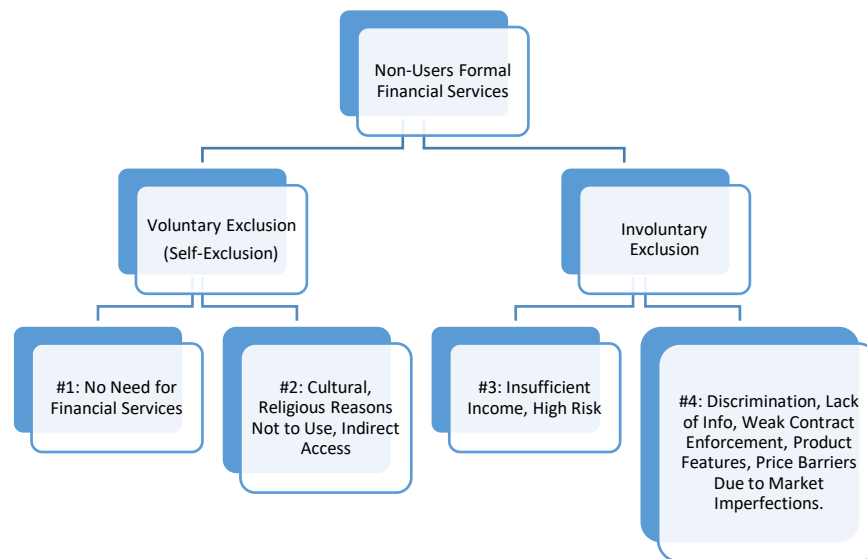
The success of the programs of microfinance as Grameen Bank in Bangladesh, BancoSol in Bolivia relies heavily on the notion that borrowers can utilize their social capital to overcome many of the problems associated with asymmetric information in credit markets (e.g., adverse selection, moral hazard, state verification, and contract enforcement) (Gomez and Santor, 2001).

Hence, The 2014 Global Financial Development Report (World Bank, 2014) identifies four major forms of financial exclusion, which are classified into voluntary and involuntary exclusion. From a

macroeconomic perspective, the main objective for building an inclusive financial system should be, in principle, the minimization of the percentage of individuals and firms in group 4 of Figure 1. In many developing economies, financial institutions are routinely faced with a number of barriers that lower their efficiency. For instance, because of various shortcomings in contract enforcement and a poor information environment, formal financial institutions in a number of developing economies are overcautious about extending loans to individuals or firms, especially small and medium enterprises (SMEs) (Amidzic, et.al, 2014).

Given the notion that mostly borrowers or customers of microfinance that have several limitations; lack of working capital, low human resources, as well lack of knowledge and technology (Sudaryanto & Hanim, 2002) excluded from financial services, this paper argues that social capital offers an alternative solution to overcome the problem of those particular customer microfinance (cooperative). The existence of social capital as a means for them to overcome many barriers to have an access to financial service and hence may strongly function as sources or determinant factor for successful operation of microfinance institution, including Islamic cooperative institution.

The significant role of Islamic microfinance is how they could articulate the collaborative nature of Islamic moral economy in the form *ukhuwwah* (social capital) among the poor participants' program. Sharing or collaborative economy in this business platform is how poor participants of Islamic microfinance-group lending model (GLM) based, which considered as unbankable or even un-bmtable share they risk, having mutual trust, cooperative, collective responsibility to have an access to social as well as financial services provided by any form of philanthropy aids.

Figure 1: Financial Exclusion

Source: Adapted from World Bank (2014)

The paper will accordingly explore the concept of social capital and its relevance with Islamic microfinance institution (cooperative). It will be organized as follows: section 2 will discuss about the modern theory of social capital and its relevance with economic performance, followed by exploring the role of group-based Islamic microfinance institution in social capital formation in section 3, and then end up with a discussion of finding and conclusion.

LITERATURE REVIEW

Modern theory of Social Capital (TSC)

A discussion on modern theory of social capital in this paper is very much related to the premise that the existence of social capital would lead to the achievement of desired outcomes in a range of human life. Social capital has been identified as a construct that may be related to desired outcomes in a range of policy areas including social, educational, and community development. Hence, the social capital possessed in various communities has been estimated and shown to be correlated with many desirable aspects of human existence, including quality of health and housing, longevity, educational qualifications, level of employment, assets and salaries (Sankey & Wilson, 2007).

These findings have attracted the interest of social scientists. To the extent that these relationships have implications for policy, hence the findings are of interest also to government. Some social scientists and most notably Putnam and his associates have made strong

claims for the benefits of enhanced social capital. In this context, Putnam and Feldstein make the following claim for the effects of social capital to the desired outcome in the context of economy: Economic studies demonstrate that social capital makes workers more productive, firms more competitive, and nations more prosperous (Putnam and Feldstein, 2000).

There is no set and commonly agreed upon definition of social capital and the particular definition adopted by the study will depend on the discipline and level of investigation; many of them refer to manifestations of social capital rather than to social capital itself (Fukuyama, 1999). The term of social capital was introduced by Lyda Judson Hanifan in The Rural School Community Center of America in the early of twentieth century. The term was referring to intangible assets, such as goodwill, fellowship, sympathy, and social intercourse among individuals, underpinning sociality.

In addition to such Hanifan information, in fact the term social capital has been used to describe what the Frenchman Alexis De Tocqueville in Wilson observed in the US in 1835 - a propensity for individuals to join together to address mutual needs and to pursue common interests. What he described was the level of community - community spirit, civic engagement, a sense of individual stewardship or trusteeship for the common good, a sense of being recognized and valued, a sense of belonging. He noted that it was the influence of customs (social capital) that produces the different degrees of order and prosperity which may be

distinguished in the several Anglo-American democracies (Wilson, 1997).

It takes some times to become a popular concept in social science debates. It begins with the work of Loury, where he stated that social capital stems from social relationships among community members in fulfilling their individual interests. It is said that social relationship is not only the essential component of social structures but also a resource that facilitates individuals to achieve their best interest. Loury further explains that social capital is a set of resources emerged within family and community relation. It is important for the cognitive development of young person through the accumulation process of human capital (1977).

The concept of social capital started to have extensive attention in the academic discussion when Coleman popularized it through his writing entitled *Social Capital in the Creation of Human Capital* (Coleman, 1988). A study on social capital further becomes more popular with the emergence of Putnam's dissertation entitled *Making Democracy Work: Civic Tradition in Modern Italy* and his publication entitled *Bowling Alone: America's Declining Social Capital* and stimulated a flurry of research and writing, including efforts to apply the notion of social capital in disciplines as disparate as criminology, epidemiology, and economics, not to mention sociology and political sciences. The World Bank has recently institutionalized the concept in its evaluation criteria by requiring social capital assessments for current and future projects (Edwards et. al., 2001). Hence, studies, publications as well as discussions regarding social capital in various aspects including economic aspect also developed extensively in the last decades.

Coincide with the extensive research and writing on social capital concept, there was also an effort to put forward the affirmative definition of social capital by some prominent scholars. The contemporary authors, who are responsible for bringing the social capital debate to its current popularity, include Bourdieu, Coleman and Putnam (Claridge, www.socialcapitalresearch.com). In a similar perspective to that of Loury, Bourdieu refers to social capital as: "The aggregate of actual and potential resources which are linked to the possession of durable networks of more or less institutionalized relationships of mutual acquaintances or recognition or in other words to membership of a group – which provides each of its members with the backing of the collectivity – owned capital a 'credential' which entitles them to credit, in the various senses of the world" (Edwards, 2001, Quibria, 2003).

In Quibria opinion, this definition is highlighting the network aspect of social capital, i.e. the opportunities and advantages that accrue to individuals from group membership. Bourdieu's concept of social capital is essentially individualistic. In his writings, Bourdieu focuses on the instrumental value of social capital in deriving economic and social benefits from group membership and the impetus for individual investment in such membership (Quibria, 2003).

In addition to the network aspect of social capital, Loury further notes in his paper: "In actuality Individuals are embedded in complex networks of affiliations: they are members of nuclear and extended families, they belong to religious and linguistic groupings, they have ethnic and racial identities and they are attached to particular localities. Each individual is socially situated, and one's location within the network of social affiliations substantially affects one's access to various resources. Opportunity travels along these social networks" (Loury, 1999). Emphasizing social network, Loury's view of social capital closely parallels that of Bourdieu in its micro perspective as an individual asset that affects one's economic locus in society (Quibria, 2003).

Perhaps the most influential formulation of the concept of social capital, nevertheless, is that of sociologist Coleman. Coleman defines social capital by its function. It is not a single entity, but a variety of different entities having two characteristics in common: They all consist of some aspect of social structure, and they facilitate certain actions of individuals who are within the structure. Like other forms of capital, social capital is productive, making possible the achievement of certain ends that would not be attainable in its absence. Unlike other forms of capital, social capital inheres in the structure of relations between persons and among persons. It is lodged neither in individuals nor in physical implements of production" (Coleman, 1990, Coleman, 1988, Edwards et. al., 2001).

Just as physical capital is created by making changes in materials so as to form tools that facilitate production, human capital is created by changing persons so as to give them skills and capabilities that make them able to act in new ways. Social capital, in turn, is created when the relations among persons change in ways that facilitate action. Physical capital is wholly tangible, being embodied in observable material form; human capital is less tangible, being embodied in the skills and knowledge acquired by an individual; social capital is even less tangible, for it is embodied in the relations among persons. Physical capital and human capital facilitate

productive activity, and social capital does so as well. For example, a group whose members manifest trustworthiness and place extensive trust in one another will be able to accomplish much more than a comparable group lacking that trustworthiness and trust (Coleman, 1990).

Similar with that of Coleman, Putnam terms social capital as features of social organization, such as trust, norms, and networks, that can improve the efficiency of society by facilitating coordinated actions" (Putnam, 1993). At this point, the above discussion could be concluded that the value of social capital can be identified as the functioning of social relationship and networks in the achievement of group's interest. Hence, the importance of interrelationship is emphasized further by O'hara through defining social capital as a durable process of communication and interaction within the community that can establish and promote networks, trust, social obligation and practices (O'hara, in Nugroho, 2008).

Social Capital and Economic Performance

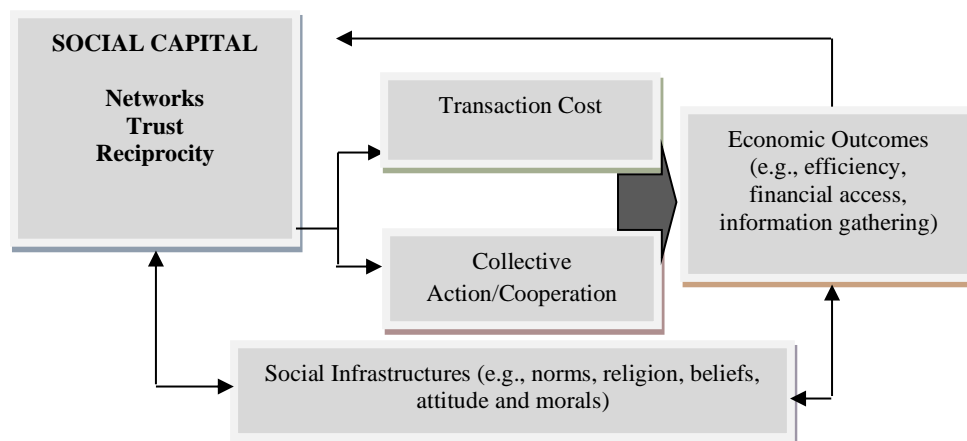
Social trust and networks are the key ingredients of social life. People are willing to have close contacts and build up friendships because they believe that others will behave in a way of being expected. At the same time, mutual trust among them is strengthened when such relationships have been sustained. Hence, it is rational to define social capital as the interconnected linkage between social trust and networks, facilitating individuals to achieve their socioeconomic goals (e.g., economic performance). However, the extent that social

trust and networks lead to the formation of social capital, and then contribute to socioeconomic activities is influenced by social infrastructures, such as norms, values, religions, beliefs, and the like. In contrast to Putnam, norms and beliefs are not seen as the key component of social capital, rather they play a facilitating role of social trust and networks in constructing social capital (Putnam, 1993, Smidt, 2003). There are two reasons for this; Firstly, norms are a "moral judgment" to consider whether the behavior of individual is being socially acceptable or unacceptable (Lyon, 2000), and they can take a various form, such the norms of friendship, loyalty, reciprocity, egalitarianism and many others.

Secondly, norms share a similar role with religions and beliefs, facilitating individuals (groups) to build and sustain social interactions (networks) and trust. Therefore, norms are better seen to be the component of social infrastructures, facilitating the ups and downs of trust and networks within the community. For instance, when the norms of acceptance, friendship, loyalty and egalitarianism are strong in the community, they can help people to develop mutual trust, communication, networks and sociality (Nugroho, 2008).

Similarly, religious practices can strengthen mutual trust and networks across different religions by nurturing their religious members with tolerance. Conversely, when religions fail to enhance tolerance, the religious majority suppresses the minority, preventing them from having equal opportunities and power in the community.

Figure 2: The Circular Linkage between Social Capital & Economic Performance (Nugroho, 2008)



The question to rise is the extent that social capital affects economic performance, including in the practice of microfinance. Figure 2 presents the circular linkage between social capital, social infrastructures and economic performance (Nugroho, 2008). Social capital contributes to economic performance through their capability to practice and sustain mutual cooperation, mutual trust (reciprocity norms) and reduce transaction costs involved in production and exchange. At the same time, the resulting production and exchange can lead to the social capital accumulation, when they are characterized by equal distributions of power and income among community members. Having such social capital within the group proves to be an effective and efficient way to reduce the transaction costs in credit delivery and disbursements (searching, monitoring and enforcement) of the lender by shifting onto the groups as well as securing loan repayments (Dusuki, 2006).

Agents or participants are willing to engage in collective actions (cooperation) due to the following reasons; Firstly, any individual levels, economic agents are willing to sustain long-term cooperation because they care about one another. If each agent is well informed than he/she will take care of each other, he/she will trust one another to carry out their obligation. When each agent behaves honorably toward his/her obligation, monitoring costs are lowered due to the absence of moral hazard problem.

Secondly, at community levels, agents will sustain their obligation because violating agreement of collective actions can lead to social exclusions. In the society, the dispositions to be trustworthy at personal and communal levels are exist at various degrees. Having feelings of shame, incredible, and socially excluded in the case of violating collective agreement will encourage agents to honor their obligations. In other words, the absence of social capital would lead someone to financially excluded and even socially excluded. In a broader concept, social exclusion is a process (and its outcome), whereby individuals or groups become detached from group or broader social relations (Sirovatka and Mares, 2008). It involves not only low income/poverty, polarisation, differentiation, and inequality on a vertical social axis, but also the state of being in or out a circle (Burchardt, Le Grand and

Piachaud, 1999), as a consequence of mechanisms that act to detach groups of people from the social mainstream (Giddens, 1998). An individual is socially excluded if (a) he or she is geographically resident in a society and (b) he or she does not participate in the normal activities of citizens in that society, where normal activities may refer to the following: consumption activity, savings activity, production activity, political activity, and social activity (Giddens, 1998).

It is therefore can be claimed that social inclusion and social participation are usually grounded in some form of social capital (Sirovatka and Mares, 2008). The same opinion has been addressed by Simplican, Leader and Kosciulek (2015) that social inclusion can also become interchangeable with social capital. This occurs when definition of social inclusion includes benefits like increased trust, reciprocity, and personal efficacy that may result from social networks and community involvement. To sum up, social capital in its totality affects social inclusion, an individual's quality of life and personal development, but also economic growth, democratic governance and social cohesion at the macro level. The dimension of social capital and social exclusion/inclusion is as depicted in figure 3.

Thirdly, long-term interactions and cooperation can generate self-enforcing mechanism to sustain business agreement. As agent can observe one another's action, outside party is less needed to enforce the agreement. In microfinance, rotating saving and credit association (ROSCA) is an example that long-term interactions can become self-enforcing mechanism for the members to sustain the ROSCA agreement. The members of ROSCA are unlikely to violate the agreement because they are afraid of being socially excluded within the group/community.

Fourthly, reliable enforcement agencies can provide incentives for agents to sustain economic agreements. This agency may not necessarily be formal institutions but also informal one. In the rural community, religious and ethnic leaders for instance, can be effective enforcement authorities for sustaining any economic agreement. However, to be an effective enforcement agency, the important factor is if agents recognize reputation and credibility of such authorities (Dasgupta, 2002).

Figure 3: Dimensions of Social Capital & Social Exclusion/Inclusion

Social Capital	Social Inclusion (Participation)
	Economic:
	- Labour market – unemployment/employment
	- Consumption (material deprivation)
	Social:
Support from informal networks (family, neighbours, friends)	- (non)participation in informal networks
Support from formal networks (associations, civic sector)	- (non)participation in civic society (formal voluntary networks)
Support from institutions (welfare state, etc.)	- (non) access to institutions
Inclusive effect of shared norms & a climate of trust	- (dis)respecting norms, moral (generally acceptable) behavior
	Political/civic:
	- (non)involvement in the political process (election & other activities)
	- (non)membership of political groups (parties) & their activities

Source: (Sirovatka and Mares, 2008)

In the informational asymmetric world, social trust and networks contribute to economic performance through reducing transaction costs of any economic contract. When networks are strong, information about credibility and reputation of agents will be easily observed, strengthening mutual trust among agents. It does so, for instance, through pooling information (e.g., gossip) about agents' reputation and credibility. In the microfinance literature this is known as peer monitoring. Coupled with strong group sanctions toward potential free-rider behaviors, peer monitoring can inhibit agents from behaving opportunistically. Varian and Stiglitz reveal that group lending with joint-liability principles can generate incentives of group members to monitor one another. This is the case as the loan default of one member declines the others' access to future loans (Varian, 1990; Stiglitz; 1990; Dasgupta & Serageldin, 2002).

Hence, peer monitoring and sanctions do help lenders to overcome informational and enforcement problems in lending to poor people. In a similar context, other scholars emphasize the importance of social cohesion or social ties between group members that can facilitate monitoring processes within a group lending (Hermes at. al., 2005, Wydick, 1999, Besley & Coate, 1995). When the group lending is characterized by

strong social cohesion among members, peer monitoring and sanctions will increase loan repayments. For instance, a study on group lending in Eritrea reveals that peer monitoring and social ties reduce the incidence of moral hazard problems in group methods (Hermes at. al., 2005).

Given the trust that exists among group members which often have known each other all their lives, there may also be a strong inducement to self-monitor so that monitoring costs to other borrowers are closed to zero. Hence, group lending provides a mechanism to overcome some of the informational disadvantages of commercial lenders. Indeed, Wydick demonstrates that the social cohesion of groups in Guatemala, by mitigating adverse selection and moral hazard and by encouraging mutual insurance, is the primary determinant of group lending's high repayment rates (Coleman, 1999).

The Role of Social Capital in the Early Islamic Period

The notion of social capital or social inclusion within Islamic tradition is very much in line with a discussion on the concept of *ukhuwwah (al-Ikha)*. In Arabic language, there is a difference between *lafz اخوان* and *اخوة* although both of them are in the plural forms

(jama') from the singular lafz of اخ (which could mean brother or friend). In this case, lafz اخوة used for the plural form from singular of lafz اخ which means relatives (families who have blood relations or lineage). Whereas lafz اخوان is plural form from singular of lafz اخ which means friends (which create close relationship from a friendship instead of lineage) (Al-Razi, no year). In Surah Al-Hujurat verse 10, Allah use lafz اخوة to describe the relationship that exists between the believers (Muslims). The existing relations between them are not blood relations, whereby Muslims are so many which consists of a variety of tribes, nations and different countries. The usage of lafz اخوة for other than blood relations as they exist in this verse in the science of Arabic language (Balaghah) known as بليغ تشبيه (Al-Zuhaili, 1998; Al-Alusi, no year).

As brothers/sisters who were born from one father, the relationship that existed at the Muslim community is likened to blood relationship or lineage because such relationship is built and born through the one thing that is faith in God (Islam). Even relationships that were born from the faith are stronger than family relationships. This is because blood relations will only take place during in the world life whereas the relationship which created through the Faith will keep waking up in the hereafter (Al-Zuhayli, 1998; Al-Qurtubi, 2003). Based on the above, then the usage of lafaz اخوة in the quranic verse describes the closeness and intimacy of a relationship that is built by Islam for its followers. In which all Muslims are like a family that was born from the same father in the form of belief in Allah SWT (Al-Qurtubi, 2003; Al-Alusi, no year). Differences of race, ethnicity, culture and others have united under one umbrella which is Islam.

When the Prophet migrated to Medina, the first thing he did after building a mosque is to build social capital among the people who lived in Medina. Whereby the establishment of social capital is one main key success factors to create city of Medina. There were several steps that Rasulullah applied in order to build social capital:

First, the establishment of brotherhood between Muhajirin (migrant from Mecca) and Ansar (local occupant/community). Brotherhood entity which initiated by Rasulullah is known as *Muakhab* or *al-Ikha*. *Muakhab* or *Ikha* system was formulated in the form of laws and inaugurated at Anas bin Malik's home (Karnaen, 2008). According to Muhammad Al-Ghazali, as quoted by Antonio, the meaning of brotherhood here is the disappearance of Jahiliyyah tribal fanaticism, no spirit of devotion in addition to Islam, the collapse of all

forms of difference that is based on the origin of heredity, color, and regional origin or nationality, as well as chops and changes someone just depends on his own personality and his taqwa to God the almighty (Antonio, 2007).

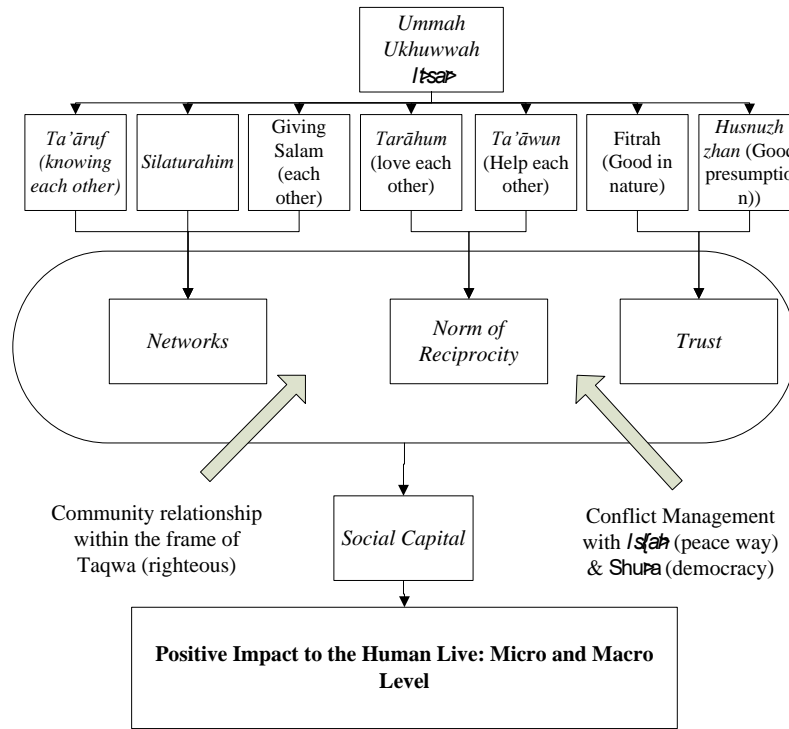
The Muhajirin who came from Mecca to Medina was facing various problems of economic, social, and health. So that the majority of the Muhajirin came to Medina is in a position of weakness and longing for their families and their homeland. This is from here the Prophet then unites them with the Ansar. There are 90 people who have been united in the form of brotherhood by Rasulullah, 45 people from Muhajirin and 45 people from Ansar. Even in a history mentioned that no one is left from Muhajirin unless all become brothers with Ansar (Perwataatmadja, 2008).

One famous example of the brotherhood implementation in the early Islamic tradition is brotherhood between Abdul al-Rahman bin 'Awf and Sa'd ibn ar-Rabi'. When Rasulullah made them in brother, Sa'd bin Ar-Rabi 'says to Abdul al-Rahman bin 'Auf "I belong to the Ansar who had many wealth or possessions. I will treasure it for two, half for you and half for me. I also had two wives, where you see the most interesting. Call her name, she will soon I'm divorced. After the mortgage discharged, I invite you to marry her". But the offer was rejected with the smooth by Abdul al-Rahman bin 'Auf. Abdul al-Rahman bin 'Auf then replied "May God bless your family and your wealth. Just show me, where is your market town." After hearing the answer from Abdurrahman, then Sa'd show him Bani Qoinuqa market. With the expertise and skills in trade, finally Abdul al-Rahman bin 'Auf able to gather a lot of wealth and success of having trade caravans that runs the trading business into other areas (Antonio, 2007).

Fraternity or brotherhood system that was initiated by the Prophet was warmly welcomed by Ansar. They are freely willing to share half of their wealth to their brethren, namely the *Muhajirin*. The very intriguing generous attitude of Ansar is touching the hearts of the *Muhajirin*. In a narration from Anas disclosed that the *Muhajirin* ever ask a question to the Prophet, "O Messenger of Allah, we have never come to a society such as the *Ansar*. If they have a little of goods, they are the best people that we are witnessing attempt to provide assistance. If they have a lot of goods, they were the best people who sacrificed. They have given us everything we needed and allowed us to participate in their happiness. We are concerned that they will get all the reward from Allah. Responding to the questions

from the *Muhajirin* the Prophet replied "No, as long as you respect and pray for them" (Umari, 1999).

Figure 4: Social Capital Dimension in Islamic Tradition According to Surah Al-Hujurat, Verse 10



Sources: Al-Faizin & Sanrego (2010)

Second, reconcile the tribes who are always in fighting. Before Rasulullah (Peace be Upon Him), the Arab nation is a nation that is very often in conflicting and in fighting each other. Every Arab tribe had always prided the advantages possessed by their respective tribes and trying desperately to keep their honor. This can be seen from the word of Muqatil ibn Hayyan that at one moment Aus and Khazraj tribe boasting each other of their own tribe.

Two tribes that have been reconciled by the Prophet is the tribe of Aus and Khazraj, where the two often clashed since the time of *Jabilyyah*. According to Muhammad ibn Ishaq the tribe Aus and Khazraj actually originated from one father and one mother (siblings). But both experienced hostility after the events of the murder of one of their members (Al-Baghawi, 1997). Each of the tribe of Aus and Khazraj has allies who help each of them during the battle. The allies of the tribe of Aus are the tribe of Banu Nadhīr and Bani Qurayzhah, while the allies of the tribe Khazraj was Banu Qainuqa (Al-Tabari, 2000). Hostility and battle between the two has been going over 120 years until they finally managed to be reconciled by the Prophet (Al-Baghawi, 1997).

Third, embrace all groups, especially minorities or groups that differ with the Prophet to build together the city of Medina. In this case Rasulullah embrace Jews to working together to build the city of Medina. This can be seen in the Medina Charter Article 16 and Article 25 to Article 35.

The discussion on this part indicate that although the concept of ukhuwwah is exclusive in nature, but practically it lead to good deeds in which not exclusively belong to muslim. The concept of ukhuwwah, by nature, is a platform that address the application of *amar ma'ruf nahi munkar* (commanding the good and forbidding evil), noble and love. Legislation of muakhkhah system yield the right-of privileges between the two sides became brothers. For example helping each other. It is not limited to specific issues, but open to all forms of help in solving the problems of life, whether in the form of material aid or supervision, advice, silaturrahim, and love. Muakhkhah system also creates a new situation, that they may inherit each other without any kinship. This fact brings their relationship at a level which is so vast, even higher than on the basis of kinship fraternity (Sanrego and Taufik, 2016). To sum up, social capital in Islamic tradition was encompassing both the form of

structural and cognitive social capital which complement each other; whereby structural capital facilitates information sharing, and collective action and decision making through established roles, social networks and other social structures supplemented by rules, procedures, and precedents and cognitive social capital refers to shared norms, values, trust, attitudes, and beliefs (Grootaer and van Bastelaer, 2002).

DISCUSSION

Group Lending Model (GLM) on the Formation of Social Capital

Why Group?

Actually there are some entities that can ascertain the attainment of social capital in certain communities. Ahmed identifies that there are, at least, three vital institutions that create productive social capital in an Islamic framework. The First is the role of civil society scholars to create an enabling environment. The second institution is the mosque as producer of social capital in local communities, and finally strong families generating balanced and productive citizens (Ahmed, 2009). However, the term of civil society put forwarded by Ahmed is very much related to the role of group as a means to establish social capital within society (Dusuki, 2006).

Group is a collection of individuals who have regular contact and frequent interaction, mutual influence, common feeling of camaraderie, and who work together to achieve a common set of goals. Group is two or more people that form a group on grounds of similarities, interact through certain mechanism in order to achieve collective goal within long period of time. Group dynamic sector is mainly related to the behavior of small group (Luthan, 2006). Group has certain features that are: consist of individuals; dependence each other; sustained participation; self-reliant; selective either from member side, goal, active etc; relatively homogeny.

Group is two or more people who interact with and influence each other toward a common purpose. Another definition that a bit comprehensive is stated by MicroSave that group is two or more individual who interact each other; mutually dependence; assign themselves and assigned by others as part of group; share each other and active in certain system or mechanism where they are involved in; reciprocally influence; there exist group benefit; attempt to reach common goal and exist the ability to act in the same rhythm (www.microsave.org). Group also can be defined as two or more individuals having face-to-face

interaction and they are clearly aware of their membership in the group. They are mutually aware of the existence of others as group member, and they are mutually aware of being positively interdependent in realizing common goal.

From those various definitions, it could be concluded that group is a collection of two or more individuals who have the same needs, interests, and common set of goals; interdependence and mutual influence; face-to-face interaction; have certain structure and framework; there exist testimony from each of them that they are members of group and are able to act within the agreed ways.

The following is type of group that can be used as a reference to analyze further what kind of group the objective in this research is categorized into. Group can be categorized into some categories. It can be in the form of group structure, group function or even in the form of group interaction pattern. Based on its structure, group is divided into two categories, namely: 1) Formal group where its structure is completely formal and inflexible, 2) Informal group which is based on friendship and very flexible in nature. Based on its function, group can be divided into two types, namely 1) working group where there should be certain works to be done, 2) social group which is formed for the pleasure of their members. While according to the interaction pattern, group can be classified into three types, namely: 1) Interacting Group, where every member must cooperate with other members in order to achieve the goals of the group; 2) Co-acting group, where each member can act alone, but all lead to the achievement of group goals (shared goals); 3) Counter-acting group, where group is divided because each has different goals/contrast/compete (http://www.articlesbase.com/human-resources-articles/).

Another form of group related to the work of non-market institution is self-help group. Self-Help Group (SHG) is a group that is trying to help themselves in groups. This group is often referred to as self-help groups. It is in the form of savings and loan association which is very old and it is commonly found in the world. These self-help groups play an important role in mobilizing savings in many developing countries (Gugerty, http://www.sscnet.ucla.edu). Based on the concept of "self-help", a small group of women form groups consisting of ten to twenty people and accumulate savings for its members lent to members who need them. In India, Self Help Groups or SHGs represent a unique approach to financial intermediation.

The approach combines access to low-cost financial services with a process of self-management and development for the women who are SHG members. SHGs are formed and supported usually by NGOs or (increasingly) by Government agencies. Linked not only to banks but also to wider development programs, SHGs are seen to confer many benefits, both economic and social. SHGs are expected to extend financial services to the poor, and contribute to the alleviation of rural poverty (<http://www.edarural.com/documents/>).

Another term of group which is related also to this paper is the term of reference group. Reference group is those who influence or become the reference person in making decisions on any action. Mowen defined the reference group as a group in which values, norms, attitudes or beliefs are used as a reference guide of behavior. In the theory of reasoned action or the theory of planned behavior, reference group is an element of subjective norms that influences the intention of someone to do an action (intention to behave) (Mowen, 1990).

The role of Group Lending Model (GLM) on the Formation of Social Capital (Beyond Micro Lending)

Fairly recent work in institutional economics has shed considerably the light on why the new group-based institutions have been able to perform so well, while others failed (Sharma & Zeller, 1997). The idea of group lending model is stemmed from the failure of market institution to provide financial services for poor people. As has been discussed earlier, in group lending methods non-market institutions, such as interpersonal relations and cooperation among group members can become 'social collaterals', substituting the lack of poor people to physical collateral. This collateral substitute enhances the self-enforceable repayment of group members through the functioning of peer monitoring and sanctions.

The success of group lending method, such as the Grameen Bank is said to be a prominent microfinance innovation, enhancing access of poor people to non-collateral loans (Nugroho, 2008). Hence, the remarkably successful experience of some recent group-lending programs in terms of loan recovery rates, such as those in Bangladesh, Bolivia, Malawi, Thailand and Zimbabwe, has aroused a lot of interest in replicating them in other countries (Huppi & Feder, 1989).

The most important elements of a group lending arrangement are the precise form of joint liability and its enforcement, and the extent to which the

ultimate lender interacts with the group as a whole or alternatively, with each individual member. Experience has further shown that factors such as who promoted the group formation and the group's involvement in joint activities other than credit can also affect group performance (Huppi & Feder, 1989). Hence, strong social networks and interactions can facilitate information gathering about the reliability of agents, building up mutual trust and confidence. Strong networks can stem from repeated transactions (interactions), generating incentives for agents to behave honestly. This is the case as they consider the norms of reciprocity and loyalty underlying such transactions to build reputation and credibility.

In group-lending programs, the functions of screening, monitoring, and enforcement of repayment are to a large extent transferred from the bank's agent to the borrowers – the group members themselves. Stiglitz and Varian discuss these perceived advantages of collective action in the screening of loan applicants and monitoring of borrowers (Varian, 1990; Stiglitz, 1990). The incentives for screening and monitoring the actions of peers arise from joint liability and the potential loss of access to future loans. The main argument is that, compared to socially and physically distant bank agents, group member can obtain, at low cost, information regarding the reputation, indebtedness, and wealth of the loan repayment, and about his or her efforts to ensure the repayment of the loan.

Zeller, for example, shows that members of formal group – such as informal lenders – consider peers' indebtedness in the formal market as a major determinant of credit rationing. Thus, group members are found to be able to access complex and sensitive information just like informal lenders (Zeller, 1998). It is this informational advantage that drives the suggestion of Stiglitz, Devereux and Fische that there exists more incentive for similar individuals to form groups (Stiglitz, 1990, Devereux & Fische, 1993). In addition, groups may also have a comparative advantage in the enforcement of loan repayment. While the formal lender has usually limited options to compel repayment from delinquent borrowers, group members can potentially employ social sanctions or seize physical collateral of the defaulter (Besley & Coate, 1995). In many rural societies, including the ones in Bangladesh, nonresident bank agents have little leverage in actually going to a village and seizing collateral. Furthermore, group members appear to be in a better position to assess the reason for default, and to offer insurance services to members

experiencing shocks beyond their control, while sanctioning willful defaulters.

However, it is important to note that group lending may not ensure higher repayment rates at all times. First, since the risk of loan default by an individual is shared by his peers, a member may choose a riskier project compared to the project chosen in case of an individual contract and therefore increase the probability of unwilling default. This is because the individual borrower may count on other members to repay his loan in their efforts to secure future loans. In other cases, it may be that the borrower’s assessment of his peers’ likelihood of defaulting triggers the borrower’s own decision to default (Besley & Coate, 1995).

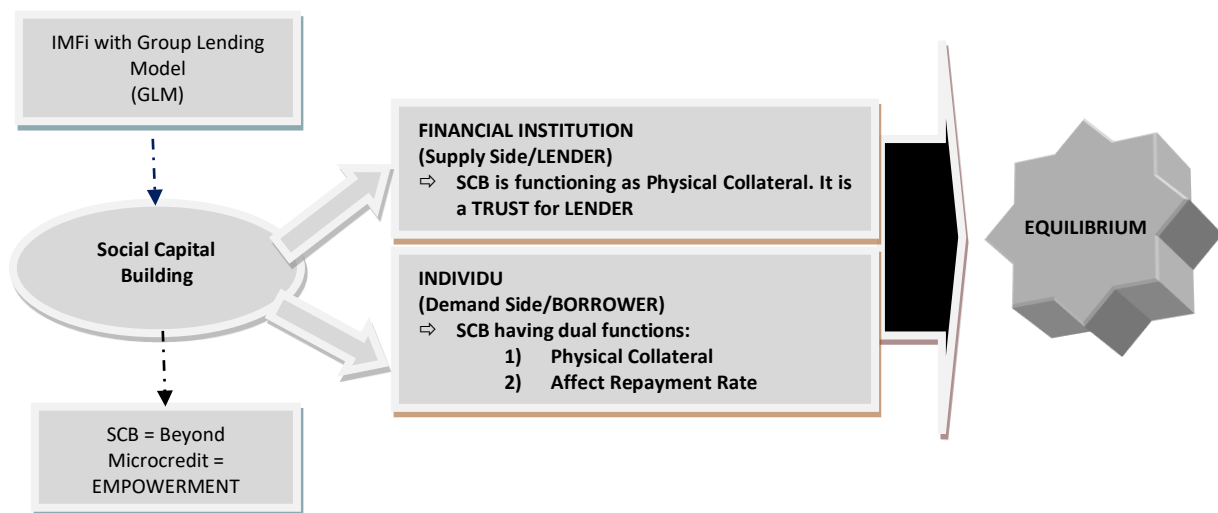
Bratton, for example, analyzes the repayment record of credit groups in Zimbabwe and shows group loans performed better than individual loans in years of good harvest (when peers were expected to repay), but worse in drought years (when peers were expected to default) (Bratton, 1986). There is also the added problem of covariate shocks, especially after a drought or a flood, when impaired repayment capability of some members coincides with the equally impaired capacity of other members to bail the former out.

For this reason, as Zeller emphasizes, individuals may attempt to exploit economies of risks by grouping

with others whose income streams are negatively correlated with theirs (Zeller, 1998). Also, sustainability of group-lending programs in areas with high covariate risks depends on the ability of the financial intermediary to reschedule the loan of defaulting members or to raise funds from borrowers during a normal year to cover such contingencies. Lastly, there is also the question of optimal group size, since groups beyond a certain size may experience increased difficulty of informational exchange and coordination; further, disincentives attached to renegeing on contracts diminish as each member may expect that the effect of his/her action on other members will be diluted (Glance & Huberman, 1994).

To sum up, while evidence suggests that repayment records of group-based credit systems are almost incomparably shinier than those of the traditional commercial banks; economic theory is still suggestive of situations where groups may actually perform badly. From the policy point of view, it would be important to know more about these types of situations, so changes in institutional design that minimize their occurrence can be made. The role of group lending model undertaken by Islamic microfinance (cooperative) program which has an impact on both lender as well as participants as customer/borrower could be summarized in Figure 5.

Figure 5: The Existence of social capital has positive impact both lender and borrower



Building Social Capital through Islamic Cooperative

The problem of poverty should become major concern of government. In the case of Indonesia, for instance, even though poor people in Indonesia have decreased considerably, but they open to be disputed since the way government measure the poverty line is

still conservative. Most of people lay a bit on poverty line that subject to fall again under poverty line even more due to economic fluctuation. This has been clearly proven whereby poor people before economic crisis in 1996 was 12% and jumped up to 40% once economic

crisis came into emergence. The same case was happening when the increasing of fuel price lifted poor rate up to 2%.

The apprehension of poverty is completely “perfect” with the increasing of unemployment rate either open or hidden unemployment. The unemployment in Indonesia was approximated 23 million and will probably increase every year for 2,5 million. Indonesia economic growth with only 5% hasn't yet absorbed the entire newly labor force. At least 8% of growth needed to absorb such a huge labor force. Hence, economic growth in the future will not emerge with its bright due to the lack of real sector. This estimation indicated by low investment, limitation of credit, and fluctuation of export performance.

At this juncture, there should be a serious effort from government to detain poverty growth. The existence of poor people around the poverty line (*transient poor*) will be increasing along with the increasing in basic necessities prices due to an increase in fuel price. Such poor people could be assisted by the compensation of fuel subsidy fund since they have ability to endure their live as well as their economic performance. However, for those who are considered *faqir* (chronic poor), aid fund in term of subsidy or direct transfer would not bring them out of poverty line. It will not release them from their basic problem which is an access to have financial services as a bridge to change their life. Therefore, it is urging for the government to disclose an access for poor people of having production factors through financial services as well as “empowerment program” so that they will not eternally live in poverty.

In Islamic tradition, the concept of poor is categorized into *faqir* (pl: *fuqara*) and *miskin* (pl: *masakin*). The former is defined as a party who needs assistance but he/she doesn't want to beg to other people, while the latter is in the contrary. It is almost unanimously agreed that the former is worst in condition than the latter. *Miskin* is has a better condition, as he/she has certain job but the income is cannot afford to fulfill his/her needs. See Yusuf Qardhawi, *Mushkilah Al Faqiri wa Kaifa 'Aljuba Al Islam* (Misr: Maktabah Wahbah, 1977), 113-114. Someone is considered *miskin* if he/she has certain job (income sources) but the income is not sufficient to cover his/her basic needs (QS 9:60). As being *miskin*, he/she deserved to have an assistance from someone who killed animal during *ihram* (QS 5:95), or from those who do not fasting because of certain reason (QS 2:184). However, inspite of having different in the term, both of these categories are deserved to have zakah. See Didin Hafidhuddin, *Zakat Dalam*

Perekonomian Modern (Jakarta: Gema Insani Press, 2002), 133.

Islamic Cooperative and Social Capital Building

The paper emphasize that having *Zakah*, *Infqah*, *Shadaqoh*, *Waqf* and *Hibah* (ZISWAH) in Islamic tradition, would lead Islamic cooperative to take a part in their role on social intermediary function. Islam provides a guidance to those who are rich to fulfill such poor right through ZISWAH mechanism. This mechanism also, according to Qardhawi, as a means to eradicate the poverty problem (Qardhawi, 1977). In addition, this system ascertain and guaranty that wealth/asset will not circulate only among the rich people. There will be a flow of fund to the needy people (Hadinoto & Retnadi, 2002). The Islamic approach is also more inclusive with a greater emphasis on the needs of the poorest of the poor (Obaidullah, 2008). The non-financial assistance in this regards is related to the role of Islamic cooperative as social intermediary (Bennet and Cuevas, 1996). Social intermediation is defined as "a process in which investment are made in the development of both human resources and institutional capital, with the aim of increasing self-reliance of marginalized groups (including the poor), preparing them to engage in formal financial intermediation". This role is clearly stated in the Ministry of Cooperative and Small Medium Enterprises Regulation No 16/Per/M.KUKM/IX/2015 Article 27 with regard to the social intermediary function of Islamic cooperative, including the usage of ZISWAH in order to create social capital.

In line with the above discussion on how Islamic cooperative can function as social intermediary, it is interesting to discuss further how Islam with its financial instruments (ZISWAH) might become another way to provide social as well as financial services for the poor which mostly scattered in the form of Micro, Small and Medium Enterprises (MSMEs). In fact, poverty in the Islamic perspective is something that really abhorred and serious problem. Rasulullah PBUH stated in his *hadith* that poverty would cause Muslim to be disbeliever (Qardhawi, 1977). On top of that, poverty do not seen as merely from financial point of view (material) but also in the context of social one (immaterial, e.g. such as knowledge, skills, confidence trustworthiness, discipline, mutual assistance) (Arraiyyah, 2007). In the context of this paper, these immaterial things are veru much related to the concept of social capital. Where, Fukuyama defines social capital as a set of norm or informal values that commonly possessed by each member of a group

which might create mutual assistance among them (Fukuyama, 2002).

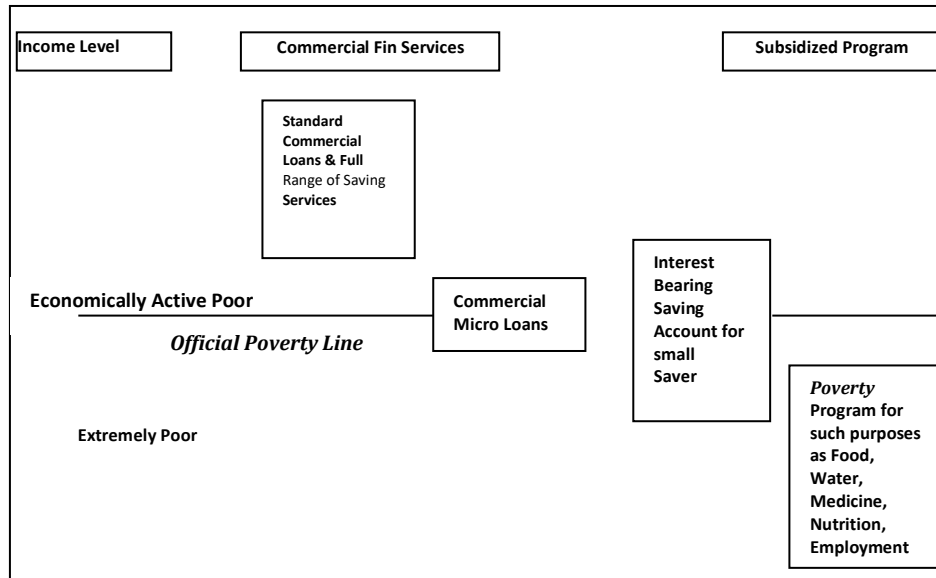
Having discussed the potential source of fund in Islamic cooperative with ZISWAH, it is likely that Islamic cooperative can lead to take the role of social and financial intermediation at once. In other words, Islamic cooperative provide charity-based not-for-profit or social based approach (*tabarru'*) as well as for-profit financing or commercial based approach (*mu'awadhat*). It may be noted that microfinance and especially micro-credit, is not usually appropriate for the chronically poor and destitute (Obaidullah, 2008). Those who are considered chronically poor, the fitted approach that should be applied is social based approach (*tabarru'*). Where, this type of poor people will have their basic needs and will benefit social intermediation undertaken by Islamic microfinance before they are able to make good use of microfinance services (financial intermediation). Using Robinson classification, the role of MFIs could be classified into three important groups; *first*, the extremely poor (*chronic poor*) whoever do not have any income input as well as productive activity. *Second*, people who are considered poor but still have any economic activity (*economically active working poor*). *Third*, whoever has income input but not much (lower income people). (see figure 6).

Loans to the destitute may in fact make the poor poorer if they lack opportunities to earn the cash flow necessary to repay the loans. Indeed, the other word for credit is debt. A destitute may be reluctant to incur debt and start a microenterprise because of risk and uncertainty with cash flows. Usually the individual may

not possess entrepreneurial and technical skills needed for wealth creation. Such an "economically inactive" individual would be "unbankable" and would find it difficult to obtain financing from "for-profit" microfinance institutions. Indeed, more than financial services, these individuals must be provided for their basic needs, such as, food, shelter, or guaranteed employment (social safety nets) (Qardhawi, 1977). Such safety nets may be funded through charity. In an Islamic system, for greater priority is given to the needs of the chronically poor than those of the poor or the moderately poor or the not-so-poor. Islam provides for a mandatory form of charity – zakah that is called the third pillar of Islam - and many other voluntary forms of charity (Obaidullah, 2008).

However, in order to cross the skill related barrier, such individuals would also need training for skills-development including self-reliance before they are able to make good use of microfinance services. The safety nets may then be linked with microfinance or cooperative programs, so that the same individuals may move through several stages – from abject penury to a stage where they are able to meet their consumption needs - then to a stage where they come to acquire necessary technical and entrepreneurial skills for setting up microenterprises - and then to a stage where they are able to obtain required funds from micro financing institutions (MFIs) and have the microenterprises up and running . Fighting poverty thus, would require an integrated finance-plus approach or the provision of financial services along with business development services and that is linked to social safety nets.

Figure 6: Financial services in poverty alleviation toolbox (Robinson & Rudjito, 2003)

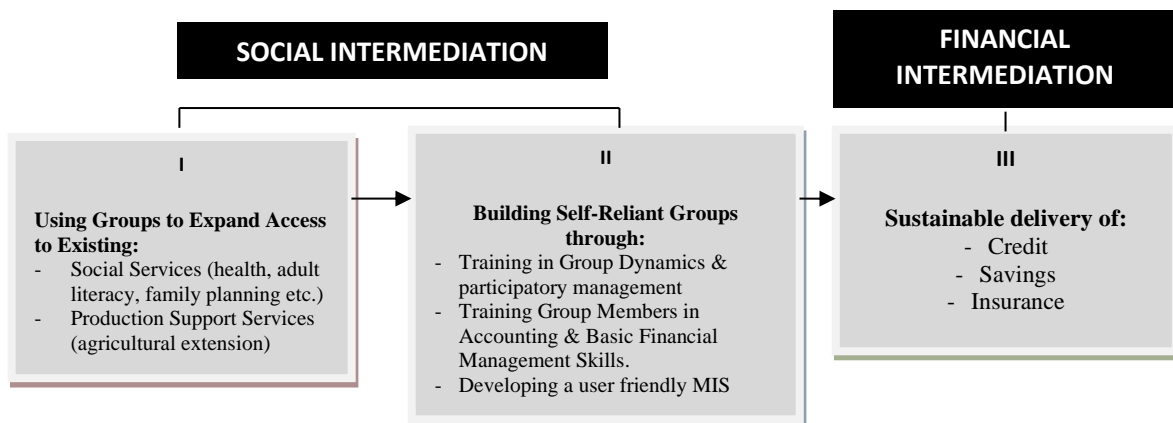


Source: Marguiret S. Robinson (2000)

At this point, both social intermediation and financial intermediation are can be applied by Islamic cooperative to empower the poor in their non-financial and financial capacity within the framework of Islamic teaching. Therefore, the attainment or the creation of social capital within Islamic teaching could be reached

accordingly through the function of social intermediation of Islamic cooperative. The process of how the poor - particularly chronically poor or economically inactive – undergo both social and financial intermediation of Islamic microfinance (cooperative) can be seen in figure 7.

Figure 7: Social & Financial Intermediation (Bennet, et al, 1996)



Given the notion that mostly borrowers or customers of microfinance that have several limitations; lack of working capital, low human resources, as well lack of knowledge and technology exluded from financial services, this paper argues that social capital offers an alternative solution to overcome the problem of those particular customer microfinance (cooperative). The existence of social capital as a means for them to overcome many barriers to have an access to financial

service and hence may strongly function as sources or determinant factor for successful operation of microfinance institution, including Islamic cooperative institution.

The significant role of Islamic microfinance is how they could articulate the colloborative nature of Islamic moral economy in the form ukhuwwah (social capital) among the poor participants’ program. Sharing or collaborative economy in this business platform is

how poor participants of Islamic microfinance-group lending model (GLM) based, which considered as unbankable or even un-bmtable share they risk, having mutual trust, cooperative, collective responsibility to have an access to social as well as financial services provided by any form of philanthropy aids.

Case study of BITM in this study indicates that members of Islamic microfinance with GLM have a sound of trust, networking as well as cooperation (social capital). It confirmed that the existence of social capital is matter for the Islamic microfinance (BITM) to develop and maintain their role in poverty alleviation. It is therefore, any kinds of philanthropy for humanitarian aid policy (including ZISWAH) should pay critical attention to the existence of social capital in order to alleviate poverty as well as to maintain human dignity.

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