

# The Role of the Financial Services Authority for the Development of Islamic Banks Linkage with Other Financial Institutions

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## Abstract

Program linkage between Islamic Banks (IB) with the Islamic Rural Financing Bank (IRFB) intended to create an efficient synergy in developing the village economy. IB desire to expand in order to increase the number of SME customers can be realized without having to open new offices, but through the IRFB. The purpose of this study was to analyze the government's policy of linkage Islamic Banks (IB) with IRFB, Apex Organization and its implementation. The study was conducted in Jakarta, Lampung and Bekasi. Secondary data and primary data used in this study. Secondary data were obtained from the banking laws and regulations issued by Bank Indonesia. Primary data were obtained from the decision makers both at national and regional levels through in-depth interviews. The analysis used was descriptive qualitative. The results showed that the regulation regarding the linkage program between IB/IBU with IRFB not been issued by the government through Bank Indonesia and the Financial Services Authority. Actually in 2005, Bank Indonesia has issued a "Generic Model Linkage Program (GMLP)". Field findings indicate that the linkage program between IB and IRFB are necessary, especially for bank financial institutions that are still not able to finance customers with their own funds. Therefore GMLP regulation should be immediately set as BI/FSA and implemented.

**Keywords:** financial services authority, generic model linkage program, bank, Islamic

## 1. Introduction

Financial intermediation is a value-enhancing service. Banks are among the most important financial institutions in a modern economy for that service. Even though Islamic banks emerged in response to market needs of Muslim clients, they are not religious institutions. The successful operation of Islamic financial institutions has proven that this new model of financial intermediation is not only viable, but in many aspects, it is rather superior to the conventional model (Iqbal, 2013).

Based on Islamic Banking Outlook 2014 was known that the growth of Islamic banking is relatively higher than the general banking and Islamic financial (Siregar, 2013). This proves that Islamic banking is able to maintain its existence and development in the face of unstable economic situation. However, Islamic banking still faces many challenges, among others in terms of human resources, product services, networks and capital. According to Ullah (2015), in Pakistan, Islamic banks are also important because, a critical evaluation of the currently available Islamic finance models based on Shirkah, Bai, Ijarah and other provide little room for the adaptation and evolution in the service. A robust theoretically and empirically based framework for the evolution of Islamic banking service can proved to be a well-timed and much needed mechanism through which Islamic banks can develop products that meet the emerging markets needs and remain compliant with Shariah.

Meanwhile, changes the function of the institution of Islamic banking supervision and regulation of Bank Indonesia (BI) to the Financial Services Authority (FSA), is expected to maintain the continuity of the development of Islamic banking. The close cooperation between BI (macroprudential authority) and FSA (mikroprudensial authority) to be one of the important pillars of the policy direction of Islamic banking in the future (Siregar, 2013). Cooperation and collaboration between banking authorities can be further developed with the involvement of various other authorities as an important Islamic financial stakeholders and policy makers. Hopefully, there will be synergy policy and its implementation in encouraging the development of Islamic finance more integrated and cross sector and Islamic banking can contribute more significantly to the economy.

Islamic Rural Financing Bank (IRFB) has advantages compared to Islamic Banks (IB) others, because IRFB can operate in isolated areas, even in remote areas. Thus, IRFB can provide services to a wider range of the community. But there are still many factors that inhibit the growth of IRFB because of their liquidity, so it is necessary funding in order to developing well.

The purpose of this study was to assess government policies, about the linkage between the IB with IRFB, Apex Organization and implementation of government policies in Jakarta, Lampung and Bekasi.

## 2. Linkage between IRFB and IB

According to Germidis et al. (1991), IB, Islamic Bussines Unit (IBU), the conventional banking and Rural Bank (RB) conventional as well as IRFB categorized as microfinance institutions formal, while the Baitul Mal wat

Tamwil (BMT) can be categorized as microfinance institutions semi-formal. In general, microfinance institutions formal, in microfinance services have administrative procedures are very complicated, as must have collateral to be adequate legal and transaction costs include an analysis of the feasibility of the loan (appraisal), the legality of the documents, the legal status of customers, various fees and other procedures. This is the formal constraints of Islamic banking or IRFB in providing services to micro-small. In fact, a group of small micro-business customers want service that is flexible, administrative procedures are not complicated (many requirements), without collateral, and the loan is relatively small. Referring to this, the efforts to improve services to SMEs requires operational linkage between IB and IBU.

Stated by Gallardo et al. (2006) that the cooperation between large banks with small-scale financial institutions, both of which will benefit in the financing of Small Medium and Micro Enterprises (SMEs). With the cooperation, the positive benefits IRFB and BMT is the addition of funds, improved management and operational techniques of large banks in funding distribution to SMEs. On the other hand, the positive benefits perceived by major banks such as IB and IBU is a reduction level of risk and transaction costs.

IRFB in order to developing well, is very important for these institutions to collaborate or establish cooperation (linkage) with IB/IBU. Unfortunately, the results of interviews with head office Independently Islamic Bank (IIB) based in Jakarta, there has been no specific regulations from the government and BI/FSA as financial authorities in Indonesia that require IB to conduct linkage with IRFB. During this time, the attention BI/FSA to encourage cooperation linkage between Islamic financial institutions is still limited in the form of awards and training for IB are cooperating with IRFB. This was revealed from the results of interviews with staff IIB, following quotation.

*"Since 2009, BI has been trying to encourage IB, in cooperation with IRFB. For example BI is often the gathering, and in the event BI reward banks that do linkage with microfinance institutions (MFIs). In addition, BI has also organized training on how to give customers financing, risk management for IB, and regulations related to IRFB. For example, training in Surabaya conducted to understand how to determine the health level of IRFB. "*

The absence of clear regulations regarding the rule of linkage program between the Islamic financial institutions, the implementation of the patterns and mechanisms of linkage between the Islamic financial institutions are based on a model guide linkage program called "Generic Model Linkage Program (GMLP)". This guide is issued by BI since 2005. GMLP also contains code of ethics linkage program participants as well as the broad patterns of linkage IB which are summarized in Figure 1.

Figure 1 shows that the linkage program can broadly be made between Islamic financial institutions, both in the domestic market and in international financial markets. Islamic financial sector could also be associated with the voluntary sector sharia as zakat, infaq, shodaqoh, and waqaf for mutual support in the development of SMEs. In addition, the pattern of linkages between the financial institutions require supporting infrastructure in arrangement, monitoring, providing information, legality, as well as assurance from the policy makers.

Pattern linkage IB program can be done by IRFB, and Islamic Microfinance Institutions (IMI) such as BMT, Islamic cooperative and inter-branch offices are branches IB or IBU is used to channel some of the funds of Islamic banks to financing SMEs or community. Distribution of funds from the IB as manufacturer to the public, especially low-income people as consumers can be done through IRFB and BMT as a distributor. In addition to the linkage with IRFB, IB/IBU can also distribute funds to finance to SMEs through linkage with IMI (such as BMT) and Islamic cooperatives.

In general, IRFB can do linkage programs between IB/IBU and other IMI as well as cooperation with the institutions such as technical assistance providers Bank Partner Financial Consultant (BPFC), education and training institutions, universities and other institutions. Institutions technical assistance is later also expected to provide support to the Islamic financial institutions, for example in training, research and development in order to grow. Here, IRFB be working with IMI as BMT, sharia cooperatives and branch offices IB/IBU in channel financing (financial business) to SMEs. Capital sources IB/IBU can be supported by the existing public financial institutions. IB also can channel their funds through institutions filanthropi named, Islamic Voluntary Sector. However, funds are channeled through the agency usually not funds from third parties, but zakat, donation, sodaqoh and waqf (ZISWAF) sourced from its customers and employees of the bank concerned. The funds will be channeled by the IB as a Corporate Social Responsibility (CSR) to providers of technical assistance and other Islamic financial institutions as intended. Through the financial institutions, funds of ZISWAF expected to assist the MSMEs. The model of the linkage program between IB/IBU and IRFB are three kinds: executing, channeling and joint financing (see Figure 2).

Based on Figure 2, the guideline contains several points GMLP Bank Indonesia policies in order to promote the implementation of the linkage program are:

- 1) Provision IRFB performance information that would be potential participants Linkage Program;
- 2) The special treatment in the assessment of the collectibility of the Conventional Commercial Bank (CCB)/IB/IBU who uses channeling;

- 3) Consideration of the ease of opening a branch office network for IRFB;
- 4) Provision of infrastructure facilities among others reporting to BI IRFB online;
- 5) Participation in the workshop every 6 (six) months related to the activities Linkage Program;
- 6) Promotion CCB/IB/IBU and IRFB (among others: includes the name of the bank, in the website BI, include the logo as a participant Linkage Program in office of IRFB)
- 7) Linkage Program Award for CCB/IB/IBU who give the greatest credit in the Linkage Program;
- 8) BI and CCB/IB/IBU disseminate information about GMLP on each website.

GMLP issued by BI (Directorate of Banking Research and Regulation Team Banking Architecture Indonesia), also contains ethical code of participants linkage program to be followed by the Islamic financial institutions. Code of ethics between IB with IRFB is made so that neither party feels disadvantaged in collaborating. The ethics include:

- 1) IB/IBU who do Linkage Programme with IRFB, are not allowed to take over the financing to clients IRFB which is being financed through the Linkage Programme and they become a customer of IRFB.
- 2) For clients of IRFB who have climbed class (from micro to small customers) and requires larger fundings, but IRFB could not afford because of the constraints of BPMK, then IB/IBU can finance IRFB customers.
- 3) IB/IBU who do Linkage Programme with IRFB, are not allowed to take human resources of IRFB.
- 4) IB/IBU and IRFB should be transparent in providing and delivering information related to the Linkage Program to the extent not violate applicable regulations (such as financial reports, funding structure and company profiles).
- 5) For IRFB, one collateral is only valid for one Sohibul maal financing partner (IB/IBU).
- 6) IB/IBU not permitted to utilize customer data from IRFB financing for interests outside Linkage Program.
- 7) IB/IBU and IRFB implementing Linkage Programme with joint financing and channeling pattern, not allowed to burden the customer financing, the margin / profit sharing ratio that is higher than the market price for the business sector of SMEs financed.
- 8) IB/IBU who do Linkage Programme with IRFB, are not allowed to request IRFB examination report issued by Bank Indonesia.
- 9) IRFB who follow Linkage Program must maintain the health of banks.
- 10) Any violation of the code ethics by IB/IBU/IRFB reported to BI by those who feel disadvantaged.

There are general requirements for IRFB so that he can perform linkage with IB. The first is the health level of IRFB. That is the condition of performance IRFB in two consecutive periods is expressed in a healthy condition by the last inspection by BI. Second, the value of Capital Adequacy Ratio (CAR) is a measure of capital adequacy ratio assessment in the context of the soundness of which is owned by each bank. According to central bank regulations, banks must have a CAR of at least 8%. Third, the rules regarding paid-up capital which is adapted to the rules IRFB. According to BI Regulation No. 11/23/PBI/ 2009 clause 5, capital IRFB paid to BI least amount of: (a) IDR 2,000,000,000.00 (two billion IDR) to IRFB established in the Capital City Territory of Jakarta and the Regency/City of Bogor, Depok, Tangerang and Bekasi (Jabodetabek); (b) IDR 1,000,000,000.00 (one billion IDR) to IRFB established in the capital of the province outside the Greater Jakarta area and; (c) IDR 500,000,000.00 (five hundred million IDR) for IRFB established outside the territory referred to in points a and b.

Fourth, the length IRFB operates. If IRFB want to choose linkage with the pattern of executing, has been operating for a minimum of three years. When IRFB choose linkage with channeling and joint financing should have been in operation at least one year. Fifth, the provision of value Non Performing Financing (NPF), IRFB who received NPF linkage program should have a maximum of 5% in accordance with BI regulation. Sixth, IRFB can provide financial data to IB/IBU. Some of these general requirements must be met IRFB when making a linkage with the IB. In addition to the general requirements already mentioned, IRFB also must meet some specific requirements given BUS. Each IB typically have different requirements. For example, IIB provides linkage requirements for IMI or IRFB that different than Muamalat Bank, and usually more technical nature.

According to IRFB actors, linkage between IB/IBU with IRFB has been running well. Implementation of linkage between IB and IRFB has been going well based on interviews with IIB in Bandar Jaya (Central Lampung) who have done a linkage with IRFB or cooperatives and benefit from the linkage. To establish good cooperation, annually IB can be done gathering or training/socialization with alliances in some areas.

Their spirit of cooperation and mutual support between the IB and IRFB is in accordance with Islamic principles. This cooperation has a noble purpose. This is in accordance with the word of Allah in surah Al Maidah clause 2, are .... "*and cooperate in righteousness and piety* (QS 5: 2). This partnership can be implemented, in which the IB as a protector which has a breadth of experience in the field of capital and technology, while IRFB have a close relationship with the rural culture and the social network in the outlying villages that is not affordable by the IB.

Why linkage between IB cooperation with IRFB is important? The reason is according to data sources compiled from APEX Generic Model RB (BI, 2005), IB and IRFB has its advantages and disadvantages of each, as shown in Table 2.

By looking at the advantages and disadvantages of the two financial institutions it is expected that there

is a synergy between the IB with IRFB so that both can complement each other flaws with the advantages of each party. Thus, the IB desire for expansion, increase the number of SME customers as well as build the economy in rural areas can be realized without having to open new offices. An effort that requires a relatively large capital, adequate technological support, as well as studies in the social culture in the countryside can be done efficiently by submitting to the "experts", ie IRFB. The results of in-depth interviews with Islamic banking mention that they were difficult to assess the feasibility of IM in the absence of adequate information relating to the character of the owners or managers and financial conditions they have. This resulted in high risk IB to build operational linkages with small-scale financial institutions (IRFB and BMT). According Aryeetey (2008), required government policies that facilitate convenience for Islamic banking in accessing information about the quality of the business of small scale financial institutions, such as IRFB and BMT.

### 3. Methodology

This study uses a strategic management approach and policy of banks. Strategic management was used to look at aspects of operational management, financial performance, strengths and weaknesses of the program linkage, opportunities and constraints in the linkage program, and run strategy IRFB. Policy approach was used to analyze the role of government, the FSA, and the Apex institution in supporting the linkage program. Various aspects will be analyzed at the level of individual banks (IRFB/IB/IBU).

This research was done in Bekasi (West Java), Lampung and Jakarta. Selection of research sites in Jakarta based on considerations of the closeness to policy makers, especially Bank Indonesia and the FSA. Bekasi (West Java) was selected as the study site because this region has a number of BPRS, including ranking second (17.5%) in Indonesia and located not far from Jakarta. Lampung selected territories representing Sumatra and its location is also relatively close to Jakarta.

Primary and secondary data used in the analysis simultaneously. Primary data is a policy that is carried out by IRFB or IB/IBU. In addition, will also be collected information about the strengths, weaknesses, opportunities and challenges, IRFB in running the linkage program. Primary data were collected through in-depth interviews and Focus Group Discussion (FGD) with IRFB leaders and resource persons from agencies FSA, BI and administrators Apex IRFB. While secondary data include the financial statements, total assets, and legislation governing Islamic banking, especially IRFB. This data is collected from IRFB or IB/IBU selected as a sample, reports or publications BI, the State Gazette, scientific journals, and the mass media.

Data and information obtained from in-depth interviews, then transcribed and combined with field notes, as well as the result of a team discussion. The analysis used was descriptive method of explaining the facts collected in a systematic, detailed and critical.

### 4. Results and Discussions

#### APEX Role in the Development of Linkage Between IRFB and IB

In the Indonesian Banking booklet 2014 issued by the FSA explained that in order to encourage the development of Rural Bank (RB) there are Apex institution that helps RB when experiencing liquidity problems. This means that Apex as a form of cooperation between the RB with the Commercial Bank has a role as the parent bank. The presence of Apex is a form of ideal synergy to jointly serve SMEs, so as to minimize the occurrence of unfair competition between commercial banks and rural banks. According to the source of the FSA, Apex term derived from the Greek meaning "protector" that has meaning for Apex also should be guidance as to the members of the RB. In general, Apex RB can serve to: (i) manage the pooling of funds and helping RB in overcoming liquidity problems due to mismatch; (ii) financing cooperation (such as the linkage program); (iii) providing technical assistance in the form of information technology development, product development, training, and payment system services; and (iv) facilitating RB in finding other sources of funding.

According to Awal (2004), one example of a successful establishment of Apex is the Credit Development Forum (CDF) Bangladesh, where CDF is an institution that organizes all MFIs in Bangladesh which was formed in 1992. Currently, the CDF has a membership of about 1500 MFIs and has facilitated four (4) major banks in Bangladesh to establish linkage with about 49 MFIs.

Based on Bank Indonesia booklet in 2014, it was clear that the development of RB in Indonesia were supported by the presence of Apex RB. Apex existence IRFB expected to function as a protector like Apex RB have not been accommodated in the Indonesian banking regulations. Though the existence of shariah Apex considered very important in helping the development IRFB. It is supported by the results of interviews with administrators Shariah Apex in Bekasi.

*"There should be Apex shariah executives / managers, clearance house, and their institutions. During Apex shariah formed based on industry demand that has been modified by Bank Danamon Syariah membership models. For bailouts given to IRFB condition in the form of membership fees. This will determine how much capital requirements given to IRFB. "*

Based on the interview with one of the directors IRFB Treasure Insan Karimah (HIK) in Bekasi, Apex

shariah has actually been formed in 2005 by members of the Association of Banks Shariah Indonesia (ASBISINDO) as one of the efforts to overcome some of the constraints experienced by IRFB including liquidity problems. Prior to the Apex shariah, a pattern of cooperation for mutual help between the members of IRFB in forms such as "social gathering" where some IRFB located in JABODETABEK made an agreement that each IRFB placing deposits IDR 20 million. Deposits were successfully collected IDR 400 million from 20 units IRFB. Next IRFB as funds were placed in one IRFB (such as social gathering).

If a member IRFB experiencing liquidity difficulties, the deposits can be used to help IRFB, provided IRFB still have to pay the mortgage. The term of repayment of these funds was agreed at the latest three months, because this is only for short-term liquidity. The pattern of "social gathering" It then became a pioneer in developing the concept of shariah Apex in 2005. However, until now Apex Shariah has not gone well. This is caused by the absence of a form of organization and clear rules of in the shariah Apex. The rules must also be agreed upon by its members, and institutionally also need legal protection and clear rules of the government or the central bank. This is consistent with the proposed Astuty (2015), the Islamic Sharia principles applied in the banking industry and Cairo is a country founded the first Islamic bank around 1971 under the name "Nasser Social Bank" operations based on a revenue sharing system (without usury). Islamic principles in muamalah that must be considered by the perpetrators of Islamic investment (related parties) were: 1) do not look for profit in things forbidden, both in terms of substance and how to get it, and do not use it for things that are forbidden, 2) no oppressing and oppressed, 3) justice distribution of prosperity. 4) the transactions carried out on the basis of the same pleasure.

Apex Concept IRFB has been carried out by Shariah Central Java Regional Development Bank, in collaboration with IRFB Central Java in August 2012. In addition, other IB has done Apex IRFB is Danamon Shariah, which in December 2012 was still IBU. Danamon Bank signed cooperation Apex IRFB with 4 (four) IRFB, are IRFB Metro Madani (Lampung), IRFB Amal Salman Al Salaam (Cinere), IRFB Artha Karimah Irsyadi (Bekasi), and IRFB HIK Parahyangan (Bandung).

In 2013, Danamon Shariah has been working with 45 (fourty five) IRFB financing. Quantity IRFB in Indonesia as a whole is 155 (one hundred and fourty five) units. The IRFB spread in West Sumatra (three IRFB), Riau (one IRFB), Bengkulu (one IRFB), Lampung (five IRFB), Jabodetabek (seven IRFB), West Java (one IRFB), Yogyakarta (six IRFB), Central Java (fourteen IRFB) and East Java (seven IRFB). Danamon Shariah has disbursed loans to IDR 130 billion for 21 (twenty one) IRFB in the linkage scheme, joint financing, and excecuting with mudharabah. Until now, Danamon Shariah remains committed to cooperating with the IRFB in the operations and Apex Bank is expected to provide financial services in the form of mandatory minimum deposit and non-financial services, including in the form of training of human resources and information technology. However, the research results Muklis et al. (2015) showed that the understanding of Islamic Bank, services, location, security, level of profit sharing, will determine the success of rural IRFB in Tangerang in the disbursement of funds.

Both pioneers IRFB protector is supposed to arouse awareness of other IB to support the advancement of small and medium businesses in the village. Awareness for synergies through cooperation by channeling capital financing to SMEs that are in the outlying village, has implications that IB does not have to force yourself to go into areas outside its market reach. This would have the glory of God in the form of forgiveness, good luck and His mercy, as mentioned in the Al Qur'an of the following:

*"And those who have believed and emigrated and fought in the cause of Allah and those who gave shelter and aided - it is they who are the believers, truly. For them is forgiveness and noble provision. (QS: 8: 74).*

*The believers are but brothers, so make settlement between your brothers. And fear Allah that you may receive mercy. (QS: 49: 10)."*

Apex of Shariah is important, because the Indonesian Association of Rural Banks and FSA can facilitate in providing policy Apex IRFB MOU with Local Government and the owners of the IB/IRFB. Rules in Shariah Apex, are also expected not contain the elements of a commercial nature. Because, basically the existence and role of Shariah Apex is needed for the development of IRFB particular helped IRFB who have difficulties in terms of funding.

The institutions of Shariah Apex has four goal. First, establish mutually beneficial cooperation (synergy) between commercial banks and RB in order to expand services to SMEs and support local economic development (regional). Second, to provide security for RB (RB Apex members) with the existence of the institution that acts as the lender of first resort to help RB especially in overcoming liquidity problems caused by the mismatch. Third, enhance the role and contribution of commercial banks in the financing of SMEs through cooperation linkage program. Fourth, optimize RB liquid funds as a source of funds under management together.

Furthermore, the function of Shariah Apex is 1) manage the pooling of funds and helping RB in overcoming liquidity problems due to mismatch; 2) conduct a joint financing (such as the linkage program); 3) provide technical assistance in the form of development and information technology, product development, training, and payment system services; and 4) facilitate RB relationships with other funding sources.

## 5. Conclusions

BI and the FSA has so far not issued a regulation regarding the linkage program between IRFB with IB/IBU. But the BI through the Directorate of Banking Research and Management Team of the Indonesian Banking Architecture 2005 has issued guidelines linkage program models called GMLP.

BI efforts to supporting the linkage program has been poured in GMLP, but unfortunately has not yet been established as Bank Indonesia regulation or FSA. Though GMLP is great for support as well as encourage the development of IRFB. Field findings indicate that the linkage between the IB program and is needed by IRFB IRFB, especially those who still have not been able to finance its customers with its own funds. Therefore GMLP regulation should be immediately set as BI/FSA.

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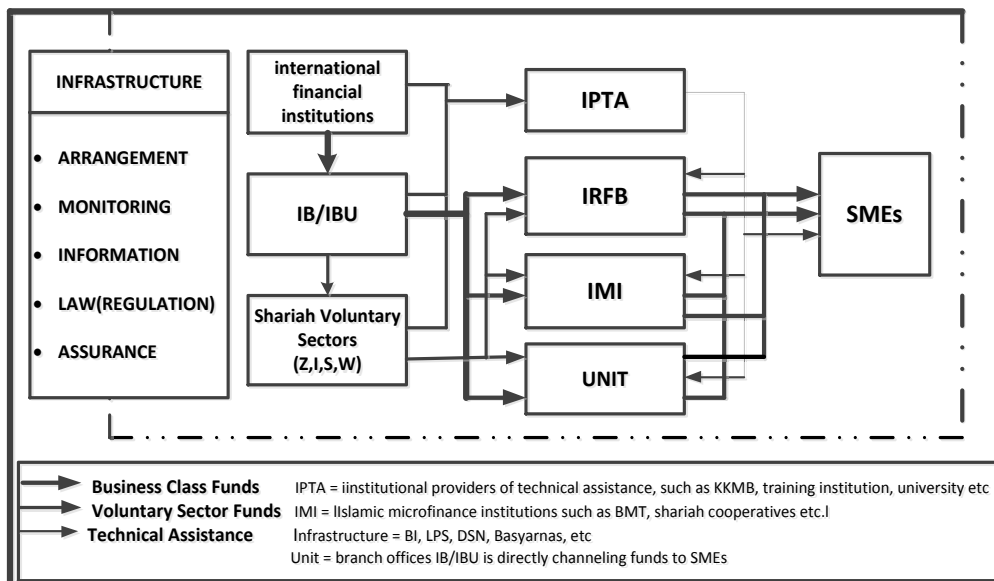


Figure 1. Islamic Bank Linkage Pattern Size

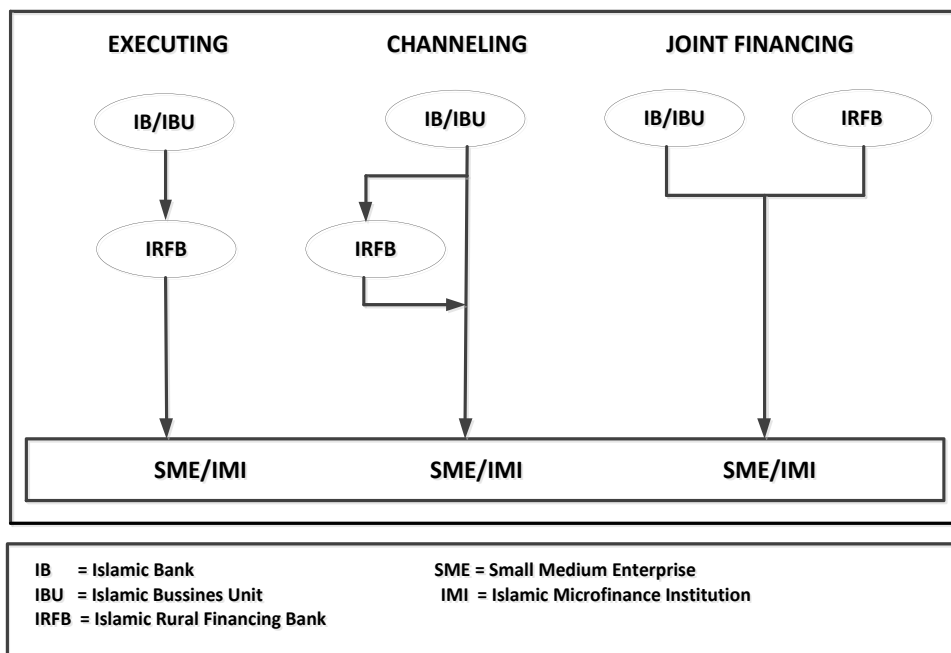


Figure 2. Model Linkage Program IB/IBU-IRFB  
 Source : Generic Model Linkage Program (BI, 2005)

Table 1. Minimum Requirements Participants IRFB Linkage

| No | Criteria            | Minimum Requirements   |
|----|---------------------|--|
| 1  | Level of health     | Executing:<br>❖ final inspection by BI, healthy; or<br>❖ two consecutive periods of inspection by BI is healthy enough<br>Channeling dan Joint Financing:<br>❖ healthy |
| 2  | CAR                 | After derive a loan > 8%   |
| 3  | Paid-up capital     | According to the provisions of IRFB  |
| 4  | Length of operation | Executing:<br>• At least 3 years<br>Channeling dan Joint Financing:<br>• At least 1 years  |
| 5  | NPF                 | IRFB receiver linkage program has a maximum net NPL 5 %  |
| 6  | Other Requirements  | ❖ IRFB may receive loans from some IB/IBU long as it meets the requirements of leverage<br>❖ IRFB can provide financial data to IB/IBU                                 |

Source : Generic Model Linkage Program (BI, 2005)

Table 2. Advantage and Disadvantage IB and IRFB

| No | Description                    | IB                   | IRFB                        |
|----|--------------------------------|----------------------|-----------------------------|
| 1. | Sources of funds               | Relatively Large (*) | Relatively Limited          |
| 2. | Supporting technology          | Sufficient (*)       | Insufficient                |
| 3. | Social and cultural experience | Less in rural areas  | superior in rural areas (*) |
| 4. | Office network in the village  | Less                 | Superior (*)                |

Source: Data processed from Generic Model *Apex* RB