

AR-RAHNU: BUSINESS OPPORTUNITY FOR CO-OPERATIVES IN MALAYSIA

Idris Ismail

Co-operative College of Malaysia

idris@mkm.edu.my

ABSTRACT

Syariah-based pawn broking or Ar-Rahnu is an Islamic pawn broking, considered to be a new product in the co-operative sector. There are many advantages in comparing Ar-Rahnu to conventional pawn broking, among which, it seems to be one of the tools to create business opportunities and to uplift the economic and social status of the members of co-operative. Bank Rakyat and a few other co-operatives in this country have shown positive results in implementing Ar-Rahnu and the average percentage in Ar-Rahnu transactions per year has increased tremendously. The ever increasing demand for this particular Islamic pawn broking services does not only mirror the economic acceptance but also reflect the fairness and non-exploitative system of Islamic finance.

INTRODUCTION

A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly-owned and democratically-control enterprise. The purpose of a co-operative is generally to provide it's members with goods and services, usually at competitive prices. On the other hand the purpose of private business is to maximise profits for its owners. Co-operative institutions, all over the world, observe the following seven universally accepted Principles of Co-operation i) Voluntary and Open Membership, ii) Democratic Member Control, iii) Member Economic Participation, iv) Autonomy and Independence, v) Education, Training, and Information vi) Co-operation Among Co-operatives and vii) Concern for Community.

Co-operatives are considered as a respectable third pillar of the national economy standing besides government and the private sector. Thus, in applying these co-operatives principles, *Ar-Rahnu* seems to be one of the tools to create business opportunities to uplift the economic and social status of the members.

Ar-Rahnu is a form of micro-credit which is recently introduced in Malaysia as a mechanism to provide the capital for small entrepreneurs and others living in poverty that is not bankable. These individuals lack collateral, steady employment and a verifiable credit history, and hence, they cannot meet even the most minimum qualifications to gain access to traditional credit.

From the perspective of Islamic law, *Ar-Rahnu* is defined when someone gives his property, regardless whether moveable or immovable, which can be sold, as security to his debt. According to The Majelle, *Ar-Rahnu* is defined as, "to make property a security in respect of right of claim, the payment in full of which from the property is permitted." *Ar-Rahnu* is also referred to an Islamic pawn broking whereby a valuable item is collateralised to a debt which may be utilised as payment should the debt not be repaid within the agreed period.

In other words, *Ar-Rahnu* is the principle, whereby something that you own (such as gold ornaments) is used as a surety against a loan. In practise, the bank or the co-operative will retain the gold as collateral, charging for safekeeping service. The gold will be valued at the current market price. The bank or the co-operatives will give a loan which represents the amount slightly lower than the market value of the gold. The safekeeping period is predetermined and agreed by both parties. At the end of this period, the borrower must repay the loan to the bank or co-operative and the collateral reclaimed. No interest is charged, but if the loan is not repaid within the agreed period, the bank or the co-operative retains the right to seize or hold the gold used as collateral.

The History and Current Status of *Ar-Rahnu* in Malaysia

Ar-Rahnu is one of the micro-credit and financial instruments or products available to all Muslims and also non-members, especially those from the lower income group. In Malaysia, there are about 160 Islamic pawn-broking branches helping the lower-income groups in order to obtain quick and easy access to cash. It comprises of Bank Rakyat which has 109 outlets, BIMB 24 and Yayasan Pembangunan Ekonomi Islam Malaysia (YPEIM) Co-operatives 15. The numbers of cumulative customers is around 1.22 million and total loans disbursed of RM1.17 billion. According to the Department of Co-operative Development, there are two other co-operatives actively involved in *Ar-Rahnu* namely Koperasi Kakitangan Badan Berkanun Terengganu Bhd. (KOKANUN) and Koperasi Kakitangan Kerajaan Kedah Bhd.

Conventional pawn broking was being introduced in Malaysia in the year 1871 by the Chinese Hakka. Actually this business was merely to create a fund among the members especially the Chinese community. Overall there are about 469 pawn shops with total loans disbursed of RM1.5 billion. Last year, 242 new pawnshop owners paid RM8.6 million for new permits. Licensed pawnshops provide loans of RM500 million in 1999 and passed the RM1 billion mark in 1990.

The number of licensed pawnshops increased by 24.7% from 194 in 1985 to 242 in 2003. Generally, the amount of national revenue from pawnshop charges increased by 145.25% to RM8,387,328 in 2003 compared to RM3,420,564 in 1985. States that showed significant changes are Kelantan (2075%), Terengganu (921%), Perlis (681%) and Sarawak (382%). Two states showed negative results in revenue are Sabah and Melaka.

Pawnshops can be considered as a small bank that provides around 0.04 percent of credit resources in Malaysia financial market. Besides that, there are 334 pawnshops at the end of year 2000 or one pawnshop for every five subsidiaries of a commercial bank. Furthermore, in that year, the amount of customers was estimated around 1,015,200 (with an average of 300 customers per month). Pawnshops are very important to the Malaysian people, especially for lower income groups (less than RM500) and low educational background. The customers of pawnshops can be classified under three groups. They are the household, private workers and government servants.

In the early 1990's, a few Islamic pawn broking institutions were established in Malaysia. The first Islamic pawn broking institution, Mu'assasah Gadaian Islam Terengganu (MGIT), was set up by the Majlis Agama Islam dan Adat Istiadat Terengganu in January 1992. MGIT is not a fully corporate body but more towards charity body in order to help persons who are in need by giving them loans with a given

time period to repay back their debts. In order to obtain the loan, one needs to give their jewellery (gold) as collateral to their debts. Since it was introduced, this institution obtained full support from all Muslims living in Terengganu as it was realised that the conventional pawn broking system still practises and adopts the *riba* based transactions.

In March 1992, Kedai Ar-Rahn (KAR), a subsidiary of Permodalan Kelantan Berhad commenced its operations. On 21 August 1993, the Minister of Finance announced the introduction of a scheme, known as Skim *Ar-Rahnu* (SAR) through the collaboration of three institutions namely Bank Negara Malaysia, Yaysan Pembangunan Ekonomi Islam Malaysia and Bank Kerjasama Rakyat Malaysia Berhad. Later, on 27 October 1993 the first phase of SAR was launched at six branches of Bank Rakyat.

Although the development of *Ar-Rahnu* is encouraging, but according to Barjoyai (1999) the value of conventional pawnshop was 82% of the total market amounting to RM1.5 billion, where else the *Ar-Rahnu* only controls 18% of the market.

Bank Negara Malaysia encouraged Bank Rakyat and YPEIM to work together in setting up *Ar-Rahnu* for various reasons such as:

- (i) Bank Rakyat is a co-operative entity and it is exempted from the provision of the Pawn Shop Act 1972.
- (ii) Bank Rakyat has branches all over the country.
- (iii) Bank Rakyat is committed to become an Islamic Bank.

According to Dr Abdul Malek Awang Kecil, the Director General of YPEIM, conventional pawnshops in Malaysia is governed by the Pawn Shop Act 1972 where the maximum interest rate is limited to 2.5% per month. The *Ar-Rahnu* scheme as carried out by YPEIM, charge a safe keeping rate of 60 cents per RM100 of the value of the collateral per month or roughly 1.33% per month.

Table 1 illustrate that the number of transactions of *Ar-Rahnu* has increased tremendously. The average percentage in *Ar-Rahnu* transactions per year has increased by 21% while the average percentage increase of disbursement per year has been 22%.

Table 1: Numbers of Ar-Rahnu Transactions and Total Disbursements (1995 – 2001)

No.	Year	Balance of the Loan (RM million)	No. of Ar-Rahnu Transactions	Total Disbursements (RM million)	% increase in Disbursements
1	1993	0.36	880	0.96	-
2	1994	19.34	44,567	36.27	-
3	1995	20.70	52,881	42.57	17.36%
4	1996	26.29	54,271	48.77	14.56%
5	1997	34.38	66,666	61.68	26.47%
6	1998	48.23	93,606	85.29	38.28%
7	1999	55.21	117,006	106.61	25.00%
8	2000	64.94	136,149	142.95	34.09%
9	2001	76.70	169,630	151.36	5.88%
	TOTAL	-	735,656	676.46	

(Source: Zainuddin Ali, Product Development Department, Bank Rakyat, 2002)

Table 2: Income from Safe Keeping Ar-Rahnu Bank Rakyat 1994-2001

Year	Income from Safe Keeping (RM million)
1994	0.89
1995	2.40
1996	2.81
1997	3.93
1998	5.79
1999	8.33
2000	10.44
2001	9.79
TOTAL	44.38

(Source: Zainuddin Ali, Product Development Department, Bank Rakyat, 2002)

Referring to Table 2, the income from safe keeping *Ar-Rahnu* has been increasing year by year except in year 2001. The highest income was RM10.44 million (2000). This shows that the demand of Islamic pawn broking services has increased and reflects the fairness and non-exploitative system of Islamic finance. The average income from safe keeping has been RM5.5 million per year.

Procedures and Conditions for Co-operatives to Start *Ar-Rahnu* Activities

The estimated cost of setting up an *Ar-Rahnu* outlet is RM250,000 and the working capital required is RM3 million. Profit will be obtained in the third year of operations. Co-operatives can apply loans from the revolving fund of the Department of Co-operative Development which provides a maximum loan of RM2 million.

The Co-operative Development Department under Rule 42 of the Co-operative Rules 1995 stated various conditions for co-operatives to run *Ar-Rahnu* such as:

- i) Minimum share or subscription of RM500,000.00
- ii) Minimum number of members is 500
- iii) *Ar-Rahnu* activities clearly stated in the By-laws of the co-operative
- iv) Annual general meeting of the co-operative approves *Ar-Rahnu*
- v) Co-operative should have a minimum RM1 million revolving fund

The Advantages of *Ar-Rahnu* Compared to the Conventional System or Other Financing Products in the Market

Ar-Rahnu has a good future and prospect in co-operatives and banking sector not only in Malaysia, but through-out the world as a whole. There are several advantages. Firstly, as compared to the conventional pawn shop, an Islamic pawnshop only charge a minimum cost (due to safe keeping) because this scheme is more towards a charitable concept rather than commercial by helping the needy people which needs immediate cash. But, it does not neglect the rights of pawnbroker to get the benefit from this transaction.

By looking at the conventional system, it charges high interest rates even up to 2% per month or 24% annually. Since the customers of this product mostly come from the lower income group, the value of the interest rate can be considered high and actually will not overcome their financial problems in the future.

To elaborate further, let us look at some basic calculations. According to *Ar-Rahnu* offered by Bank Rakyat, if the loan amount is RM1000.00, the fee/charge is RM8.33 per month. Meaning to say, one needs to pay the principal amount of owing (which the total has been spread over the period agreed by both parties) plus the fee for every month until the duration is over.

For the conventional pawnshop, if someone obtains the loan of RM1000.00, then he needs to pay the interest (lets say it charges 2%) which amounts to RM20.00 per month. Therefore the borrower needs to pay the amount owed plus the interest for every month and outstanding.

The mathematical equation for total payment should be as follows:

$$\text{Total payment (Islamic pawn broking scheme)} = \text{RM1000} + \text{RM8.33} \times Y$$

$$\text{Total payment (conventional pawn broking scheme)} = \text{RM1000} + \text{RM20.00} \times Y$$

Given that $Y =$ repayment period.

Based on the calculation above, it can be seen that conventional pawn shop charge higher interest rate, while that an Islamic pawn shop charges lower.

The second advantage that can be gained by undertaking *Ar-Rahnu* transaction is in terms of the cash amount that would be given based on the value of pawned items. In *Ar-Rahnu* scheme, most of the pawnbrokers give high amount of cash (up to 60% as offered by Bank Rakyat) while under the conventional scheme, usually it gives a lower amount as compared to Islamic scheme.

Thirdly, if the borrower fails to repay his/her debts within the repayment period, under *Ar-Rahnu* scheme, the pawnbroker has the right to sell the pawned item but he must take only the balance of the debt amount. Any gain or surplus after the deduction of debt must be returned to the borrower. Comparatively, if someone take on a transaction under the conventional system, the pawned items will totally belong to the pawnbroker (who has the right to hold or sell the item) and any balance in after deducting the debts will not be given back to the borrower.

The fourth advantage of *Ar-Rahnu* is that there is no necessity for monthly installment or guarantor. For example, Koperasi Pegawai-pegawai Kerajaan Negeri Kedah Darul Aman Bhd. kept the collateral (gold) for the period of 10 months, 6 months for savings and another 4 months of extension.

The fifth advantage of *Ar-Rahnu* is that the fee/charge is maintained according to previous rate even if the borrower extends the repayment period. Relatively, under the conventional pawnshop, the interest rate will be increased and this is against the Muslim transaction which is called *riba*.

Another advantage of *Ar-Rahnu* is that it helps Muslims or members of the co-operative who have intentions to run a business but lack the capital to do so. *Ar-Rahnu* gives immediate cash without much delay in the processing time. In other words, there is a tendency for speedy approval to obtain the loan.

Member's loyalty can be inculcated through the co-operative because they have to save their money first in order to buy gold and later use the gold as collateral to obtain loans from the co-operative. This transaction can happen many times between members and the co-operative and indirectly encourage members towards the habit of being thrifty. Through this activity the co-operative is assured of getting back the loans from members without the services of "Biro Perkhidmatan Angkasa (BPA)".

If we look at the economic perspective, *Ar-Rahnu* encourages Muslims to get involved in business. As Muslim businessmen usually have difficulties in obtaining funds through the banking system, the conditions under the *Ar-Rahnu* schemes which are more straight forward, speedier and simple provides opportunity for them to obtain funds without much difficulty.

The Negative Element and Weaknesses in Implementation of Conventional Pawn Broking

Prof Hamdan Adnan, President of FOMCA (2004), listed down a number of negative or weaknesses in the present practice of conventional pawn broking activities:

- "Decline" in value of the collateral (gold).
- Overcharging of Interest.
- Collateral (gold) valued at very low price.
- Document used hard to be read and difficult to understand.
- Auction for the collateral valued worth more than RM100 are made without informing the customer concerned.
- Excess funds based on auction was not refunded to the customer concerned.
- Auction process was not well communicated.
- Pawn shop request for advance.

Thus, the demand for the *Ar-Rahnu* scheme increased tremendously due to the ability of the scheme to overcome the critical element in delivery system of the conventional pawn system. Furthermore most of the conventional pawnshops were found to be involved in illegal and negative activities as stated earlier. In fact according to some observations, Quoting the statement of Mr. Subramaniam, Kuala Lumpur and Selangor Consumer Association Consumer Information and Documentation Manager, pawnshops are popular among petty criminals who make use of stolen items. At times pawnbrokers do not even inform their customers when their valuables are put up for auction and it is unclear whether the excess from the auction sale is given back to their clients.

CONCLUSION

With Malaysia on the fast track towards achieving the Islamic Financial Services Hub of the world, it is not surprising that the country is first in the world to be offering its brand of Islamic financial planning and products.

One of the Islamic products and services discussed is *Ar-Rahnu*. This Islamic pawn broking service is popular with both financial institutions and consumers. Providing the customer with the option to obtain cash to fulfill any immediate financial needs, this service secures a loan through a personal surety or pledge in the form of gold. Thus, the risk of having loss in this model is very low.

In the economic point of view, *Ar-Rahnu* has a great future and prospect in the co-operative sector, particularly in Malaysia. Compared to conventional pawnshop, the safe keeping charge of *Ar-Rahnu* is minimal, the amount of cash given is very high, any excess after deduction of debt through auction is returned back to the borrower and it is free from *riba*. Thus, co-operatives are encouraged to undertake *Ar-Rahnu* as it is viewed as one form of business that has a high potential of providing co-operative with a platform to enhance its contributions towards its members and society at large.

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