

## THE APPLICATION OF ISTISNA' CONTRACT IN ISLAMIC MICRO FINANCE INSTITUTION (CASE STUDY IN ISLAMIC COOPERATIVE BMI)

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### Abstract

This research aims to explore the implementation of the Istishna contract in investment financing at Islamic Cooperative BMI. The study addresses the issue that, fundamentally, the Istishna contract is a sales contract, not an investment contract. As a result, an in-depth analysis is needed to assess the permissibility of using Istishna in investment financing or to consider potential adjustments in the financing model or contract type. The research uses a qualitative descriptive approach, gathering data through interviews and secondary sources such as the cooperative's website, reports, and guidelines. It examines how Istishna is applied in investment financing and its adherence to Sharia principles, aiming to determine its suitability for use in such financing at Islamic Cooperative BMI. The findings indicate that the Istishna contract used in investment financing at Islamic Cooperative BMI aligns more closely with DSN MUI Fatwa No. 06/DSN MUI/IV/2000 on Istishna, which involves a straightforward contract between two parties. This differs from DSN MUI Fatwa No. 32/DSN-MUI/IX/2002 on Sharia bonds, where Istishna is applied in investment schemes, and also does not align with DSN MUI Fatwa No. 22/DSN MUI/III/2002 on parallel Istishna, as the cooperative already has a company dealing in building materials. Although the Istishna-based financing at Islamic Cooperative BMI complies with DSN MUI Fatwa No. 06/DSN MUI/IV/2000, it is suggested that the cooperative adopt terms such as consumptive financing, productive financing, property ownership financing, or other appropriate terms for financing schemes involving Istishna contracts. This is because cooperative members act as buyers seeking financing for development projects like housing, sanitation, and clean water provision, rather than functioning as investors.

**Keywords:** Micro Finance Institution, Islamic Cooperative, Istishna

## INTRODUCTION

In Islam, cooperatives are classified under the concept of *Syirkah/Syarikah*. Various scholars have provided definitions, as mentioned by Dr. H. Hendi Suhendi, M.Si., in his book on *Fiqh Muamalah*. For example, Sayyid Sabiq defines it as an agreement between two or more people to work together on capital and profit. Taqiyuddin Abi Bakr Ibn Muhammad al-Husaini describes it as establishing shared ownership over something through a specific method, while Hasbi Ash-Shiddieqie defines it as a partnership between individuals to manage a business and share its profits. Overall, *Syirkah* involves a joint business venture where profits and losses are shared (Ghulam, 2016).

Cooperatives conceptually reflect a transaction system based on Sharia principles. In Indonesia, however, the formation of cooperatives usually focuses on a mutual assistance system, where members contribute funds that are transparently and accountably managed by the cooperative's administrators. Surplus profits are distributed according to each member's savings (Muttaqin, 2022).

Islamic cooperatives, specifically, follow Sharia principles in both savings and financing. In Indonesia, the rise of Islamic cooperatives corresponds with growing public interest in Sharia-compliant financial institutions (Anwar, 2016). Among the contracts used in these cooperatives are *wadiah* and *mudharabah* for savings, and *murabahah* and *musyarakah* for financing (Nur'aeni, 2020). Islamic Cooperative BMI, however, offers an investment financing product based on the *Istishna* contract (Awaliah, 2020).

The *Istishna* contract is a sale agreement between a buyer and seller, where the specifications and price of the item are agreed upon in advance, with payments made in installments. This type of financing supports both investment and consumer needs, such as home ownership or renovations, in line with Sharia principles (Muslimin, 2021).

Islamic financial institutions can act as both the buyer and the seller in an *Istishna* transaction. As sellers, they can subcontract third parties to fulfill customer orders. The institution then enters into a second *Istishna* contract with the subcontractor to create the item according to the customer's request. This arrangement is known as a parallel *Istishna*, and it imposes specific obligations on the institution (Puteri, 2014). The second *Istishna* contract, with the subcontractor, is executed separately from the first contract between the institution and the end buyer (Dewi, 2017).

The Istishna contract is best suited for sale and purchase financing, where the institution profits from the margin between the selling price and the consumer price. If Istishna is applied to investment financing, a deeper analysis is needed, especially in areas with a predominantly Muslim population. Hence, the author will conduct a study titled 'Implementation of Istishna Contract in Investment Financing at Islamic Cooperative BMI.'

According to UU No. 7 of 1992, financing is defined as the provision of funds or claims equivalent to it, based on a loan agreement between a bank and another party. The borrower must repay the debt over a specified period, along with interest, fees, or profit-sharing. In BMT (Baitul Maal wat Tamwil) operations, financing is also referred to as lending. In Sharia microfinance institutions like BMT, financing plays a crucial role in income generation (Maulida, 2021).

## **REVIEW OF LITERATURE**

Financing is classified based on its purpose into two main categories; Productive financing, aimed at fulfilling broader production needs, including business development, production, trade, and investment. Consumptive financing, used to meet consumption needs.

Productive financing is further divided based on its objectives; working capital financing, designed to meet the needs for production enhancement and trade; and investment financing, intended for the acquisition of capital goods and related facilities.

When providing working capital financing, BMT or Sharia cooperatives must consider the specific needs and utilization plans. Sharia financing products can be grouped into three categories based on their purpose; Transaction financing based on sales principles, such as Murabahah, Salam, and Istisna. The income or profit from these transactions is referred to as a margin.

Profit-sharing financing transactions, including Mudharabah and Musyarakah, where income is generated through profit-sharing. Lease-based financing transactions, such as Ju'alah, Ijarah, and Ijarah Muntahiyah Bittamlik, where income is derived from fees. Financing in Sharia financial institutions is often viewed similarly to credit in conventional financial institutions. There are both similarities and differences between Sharia bank financing and conventional bank credit, including; The procedures for providing credit or

financing. The requirements for credit or financing applications made by debtors, clients, or members of the bank.

Istishna is a sales contract in which the manufacturer is commissioned to produce a customized product for the buyer. It involves an agreement between customers and banks, where the bank requests a manufacturer to create the ordered item according to the customer's specifications. The customer then purchases the item from the bank at the agreed price.

Al-Istishna is a contract based on orders between a producer (shani') and a customer (mustashni') to manufacture a specific product (mashnu'), with the producer responsible for raw materials and production costs. Payment can be made before, during, or after production.

Generally, the principles of Sharia applied to bai' as-salam also apply to bai' al-Istishna. According to the Hanafi school of thought, bai' al-Istishna is prohibited because they argue that a sales contract requires the product to already exist and be owned by the seller, which is not the case in Istishna.

Al-Istishna is a contract for the sale of goods between two parties, where the product will be made according to agreed specifications and sold at a predetermined price with pre-approved payment terms. Under this contract, the buyer commissions the producer to create the ordered goods and sell them at the agreed price.

## **RESEARCH METHOD**

The methodology section includes an overview of the Research Model, Sample Selection and Data Sources, Data Collection, and Data Analysis (Variable Measurement). This study uses a qualitative descriptive approach, which is effective in capturing procedures that produce descriptive data in the form of written or spoken words, either directly or indirectly, from the subjects studied.

The data sources consist of both primary and secondary data. Primary data is gathered directly from the object of study through interviews with informants, while secondary data comes from various sources such as books, journals, articles, and other relevant literature related to the research subject.

For data analysis, a qualitative approach is used, focusing on data that cannot be quantified or analyzed numerically in real-time. The study employs a descriptive analysis

method, which highlights events, phenomena, and current conditions. Based on the work of Huberman and Miles, the stages of data analysis include data reduction, data display, and verification.

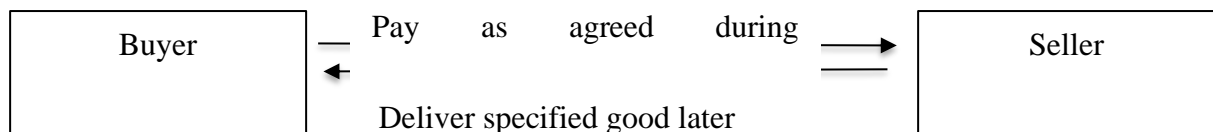
## RESULTS AND DISCUSSION

### The Istishna contract scheme as outlined in DSN MUI Fatwa No. 06/DSN MUI/IV 2000 on Istishna.

This fatwa offers a detailed explanation of Istishna, a sales agreement based on the buyer's order, laying out a comprehensive legal structure grounded in Sharia principles. Istishna is defined as a transaction in which the buyer commissions the production of a specific item according to their specifications. The fatwa bases its legitimacy on Sharia principles found in the Quran and Hadith, highlighting the theological foundation of Istishna.

Several conditions are specified for the validity of an Istishna transaction. These include clear item specifications, transparent payment terms, and guaranteed delivery. A key aspect of the fatwa is the equitable distribution of risks and responsibilities between the buyer and seller, aiming to ensure justice and fairness in line with Islamic economic principles.

**Figure 1.**  
**Istishna Scheme**



The process starts with the buyer placing an order with the seller to create or produce a specific item. The order must clearly define the desired product, including technical specifications, quality, and quantity.

After the order is placed, both parties agree on the Istishna price, which must be fixed and cannot be altered once the agreement is made. This price includes production costs, the seller's profit, and any other relevant factors.

The buyer then provides a down payment, which the seller can use to begin production. The amount of the down payment, payment schedule, and other payment details are outlined in the contract.

Upon receiving the down payment, the seller starts producing the goods according to the agreed specifications, covering all stages of production, procurement of raw materials, and necessary efforts to fulfill the order.

Once the goods are completed, they are delivered to the buyer as per the agreement, meeting the specified conditions.

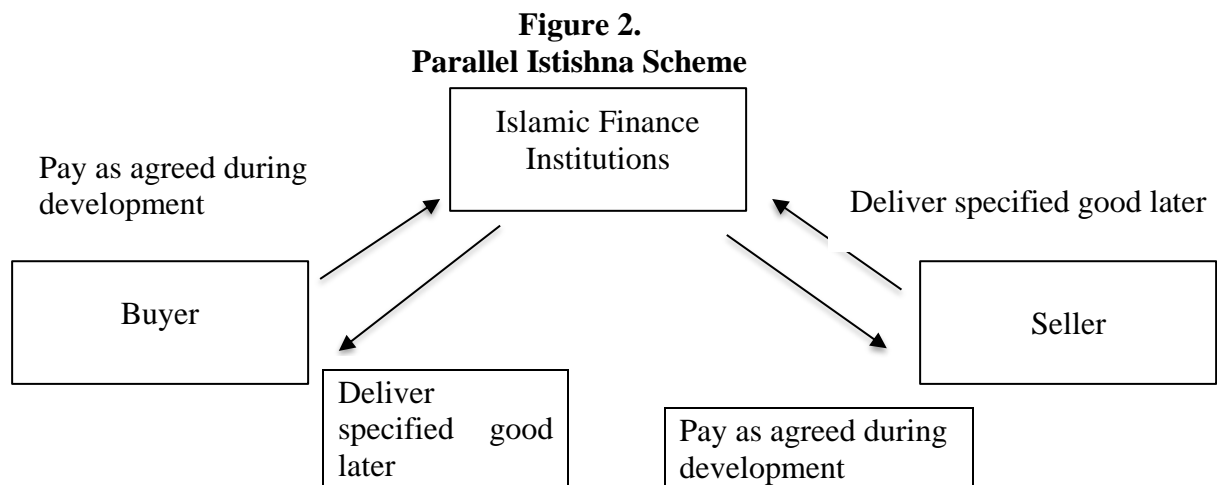
The buyer makes the final payment, covering the total agreed price, within the timeframe and terms set out in the Istishna contract.

After the final payment is received, the Istishna contract is considered fulfilled, and the seller must deliver the goods, successfully concluding the transaction

**The Parallel Istishna' scheme, as outlined in Fatwa DSN MUI No: 22/DSN-MUI/III/2002.**

This fatwa covers Parallel Istishna', a distinct variation of Istishna, characterized by two simultaneous contracts between a buyer, producer, and distributor based on a buyer's order. The fatwa is grounded in Sharia principles derived from the Quran and Hadith, providing a robust foundation for sustainable Sharia-compliant transactions.

The fatwa legitimizes cooperation between producers and distributors, emphasizing transparency and fairness. Like in traditional Istishna, the product specifications, such as materials, quality, and quantity, must be clearly defined. While Istishna is a simple contract for the sale of customized products, Parallel Istishna involves two contracts, allowing for more complex financial arrangements, often used for project financing or risk management. The key difference lies in the additional layers of contracts and parties.



The fatwa underscores the need for smooth contract execution, ensuring that transactions align with principles of justice. It also grants the distributor the flexibility to set prices for third parties, providing market flexibility and profit opportunities. This fatwa serves as a guide for producers and distributors to develop Sharia-compliant Parallel Istishna' contracts.

By legitimizing Parallel Istishna', the fatwa has significantly influenced the growth of the Sharia economy, promoting collaboration between producers and distributors within a Sharia-based business environment. However, challenges remain, such as ensuring contract compliance, managing production risks, and navigating market uncertainties.

The process begins with an agreement between the producer (*mustasni'*) and the distributor (*musharik*) to engage in parallel Istishna', involving two simultaneous Istishna transactions. Both parties agree on the price, quantity, and quality of the goods to be produced.

The *mustasni'*, acting as the producer, starts by producing the goods according to the agreed specifications after receiving a down payment or advance from the distributor. Once the goods are produced, ownership is transferred to the distributor, marking the completion of the first Istishna.

The distributor, now the owner, enters into the second Istishna transaction with a third party, who pays the distributor the agreed price. The distributor then pays the remaining balance to the *mustasni'*, as per the initial agreement.

The distributor completes the payment to the *mustasni'* and delivers the goods to the third party. The third party, as the final buyer, receives the goods according to the specifications, and the parallel Istishna is considered complete, with both the producer and distributor receiving their respective payments.

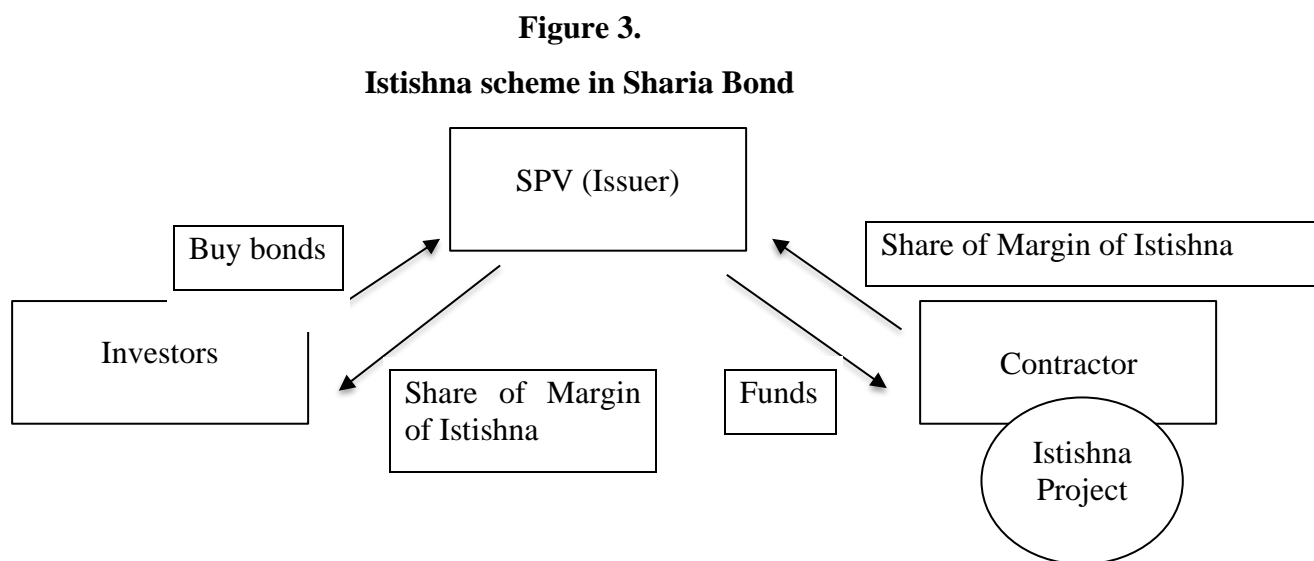
### **The Istishna scheme in Sharia bonds, as outlined in Fatwa DSN MUI No: 32/DSN-MUI/IX/2002.**

Issuers can issue sukuk (Islamic bonds) to finance specific projects or the production of certain goods. Sukuk, unlike conventional bonds that involve interest (prohibited in Islamic finance due to the ban on *riba*), are financial instruments structured to comply with Sharia principles. The term "sukuk" refers to a legal instrument or deed, with bondholders

acting as investors and essentially buyers in the Istishna context. They provide funds to the issuer, expecting returns from the completed project or delivered goods.

The DSN MUI stresses that all contracts ('aqds) in Istishna transactions, including those for Sharia bonds, must adhere to Sharia principles. The issuer must clearly outline how the funds will be used, details of the project or goods, and the rights and obligations of all parties involved. Transparency and fairness in risk and profit-sharing between the bondholder (buyer) and the issuer (seller) are key to ensuring justice in line with Sharia principles.

In this context, Istishna offers companies or governments a Sharia-compliant means to secure funding. However, the specific provisions of Istishna in Sharia bonds may differ depending on the issuer's structure and the guidelines provided by the authorities issuing the fatwa or related regulations.



Issuance of Sharia bonds (sukuk) involves a company or government entity raising funds from bondholders. This process includes documentation outlining the structure of the sukuk, the terms for using the raised funds, and how they will be allocated for specific projects or goods.

The issuer uses the funds to carry out an Istishna agreement, ordering goods or initiating projects in line with the specifications set by the bondholders, who act as the buyers. Contractors or producers then begin manufacturing or procuring the goods or projects as per the agreed specifications.

Once the goods or projects are completed, they are delivered to the bondholders, and ownership is transferred according to Sharia principles. In return, the bondholders make payments to the issuer as agreed in the Istishna contract.

Bondholders also receive scheduled coupon payments, representing profit-sharing (not interest), or principal repayments, which help the issuer recover funds invested in the project. Once full payment is made, the Istishna contract is considered complete, with bondholders receiving their principal and coupon payments as promised.

The Istishna scheme in Sharia bonds emphasizes transparency, fairness, and clarity, ensuring Sharia compliance while allowing issuers to secure funding for projects or goods according to the bondholders' specifications.

### **Analysis of Islamic Cooperatives' Compatibility with Istishna 'Aqd Schemes According to DSN MUI Fatwas**

BMI Islamic Cooperative plays a key role in promoting sustainable economic development and empowering its members through Sharia-compliant activities. One of the financing instruments it can use is the Istishna scheme, which aligns with Sharia principles. In this scheme, Islamic Cooperative members act as buyers, placing orders for specific goods or services. The cooperative then uses the funds obtained from members to fulfill these orders, either producing or procuring the goods as requested. Once the goods or services are ready, they are delivered to the members according to the agreed specifications, in line with DSN MUI Fatwa No. 06/DSN-MUI/IV/2000.

Members make payments based on the agreements established in the Istishna contract, which include the price of the ordered goods or services. This scheme ensures that profits and risks are shared between the cooperative and its members. Profits from the sale of goods or services can contribute to the cooperative's growth, while potential risks are collectively managed.

The Istishna scheme enables Islamic Cooperatives to adapt to their members' needs, allowing the cooperative to develop its activities based on market demands. This creates a strong connection between the cooperative and its members, fostering growth in line with Sharia values.

Some of the specific Istishna-based investment financing products offered by Islamic Cooperative Benteng Mikro Indonesia include; Micro Home Improvement Program: Offers

up to Rp40,000,000 in financing for home renovations. Members must have been part of the cooperative for at least two years, with the Istishna contract serving as the transaction basis. Micro Sanitation Program: Provides up to Rp15,000,000 in financing for sanitation facility improvements. New members can apply through appraisal and feasibility tests, using the Istishna contract. Micro Water Management Program: Aims to provide financing up to Rp15,000,000 for clean water access. New members undergo appraisal and feasibility tests, with an Istishna contract in place. No Down Payment Home Financing Program: Offers financing of up to Rp85,000,000 for members meeting criteria such as two-year membership, a viable business, no habitable house, at least 50m<sup>2</sup> of certified land, and no history of delayed installments, all under the Istishna scheme.

Through these programs, Islamic Cooperative fosters a close relationship with its members while offering Sharia-compliant solutions for financing and growth.

**Table 1.**  
**The Compliance of the Implementation of the Istishna ‘aqd in Islamic Cooperative BMI**

	<b>Fatwa DSN MUI Nomor 06/DSN-MUI/IV 2000</b>	<b>Fatwa DSN MUI Nomor: 22/DSN-MUI/III/2002</b>	<b>Fatwa DSN MUI Nomor: 32/DSN-MUI/IX/2002</b>	<b>Implementation in Islamic Cooperative BMI</b>
	<b>Istishna</b>	<b>Istishna Paralel</b>	<b>Istishna Investment</b>	
Member / Customer	Buyer / Orderer	Buyer / Orderer	Investor / Part of the Seller	Buyer / Orderer
Islamic Financial Institution	Seller	Intermediary with the seller	Investor / Part of the Seller	Seller
Third-Party Partner	-	Seller	Seller	-
Fourth-Party Partner	-	-	Buyer	-
What the customer obtains	Goods	Goods	Profit-sharing margin	Goods

The Istishna contract used by BMI Islamic Cooperative, as outlined in the table, follows a standard Istishna model involving only two contracting parties. This model differs from the Istishna scheme mentioned in DSN MUI Fatwa No. 32/DSN-MUI/IX/2002, which applies to Sharia bonds or sukuk in the context of investment. It also does not align with DSN MUI Fatwa No. 22/DSN-MUI/III/2002, which pertains to parallel Istishna, since the cooperative has its own company that provides building materials. However, based on the table, it is concluded that the BMI Islamic Cooperative’s use of Istishna is consistent with DSN MUI Fatwa No. 06/DSN-MUI/IV/2000 regarding Istishna.

## CONCLUSION

The Istisna contract scheme used in investment financing at Islamic Cooperative BMI aligns more closely with DSN MUI Fatwa No. 06/DSN MUI/IV/2000, which involves a regular Istisna contract between two parties. This differs from the Istisna scheme in DSN MUI Fatwa No. 32/DSN-MUI/IX/2002 related to Islamic bonds, where Istisna is used for investment purposes, and also from DSN MUI Fatwa No. 22/DSN MUI/III/2002 regarding parallel Istisna, as the cooperative already has a company that provides building materials.

The financing at BMI Islamic Cooperative using Istisna is consistent with DSN MUI Fatwa No. 06/DSN-MUI/IV/2000. However, it is recommended that the cooperative use terms such as consumptive financing, productive financing, or ownership financing for buildings in its Istisna financing schemes, as members act as buyers seeking financing for development projects (e.g., houses, sanitation, and clean water) rather than as investors.

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