



# Potential for Developing Sharia Financial Products for the Agricultural Sector in Ponorogo

Binti Masruroh

STIT Sunan Giri, Trenggalek, Indonesia

E-mail: [bintimasruroh986@gmail.com](mailto:bintimasruroh986@gmail.com)

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## ABSTRACT

Ponorogo Regency, a predominantly agrarian area in East Java, faces significant challenges in agricultural financing. Most small-scale farmers rely on informal lenders due to the inaccessibility of conventional financial institutions, which often impose strict requirements and inflexible schemes. This study explores the potential of Islamic finance as a fair and sustainable alternative for agricultural financing in Ponorogo. Using a qualitative descriptive method, data were collected through literature review, field observations, and in-depth interviews with farmers, BMT/LKMS managers, and Islamic banking representatives. The findings reveal that Islamic financial products such as *qardhul hasan*, *mudharabah*, and *musyarakah* have been positively received by farmers due to their alignment with local socio-religious values and their equitable, non-interest-based mechanisms. However, implementation remains limited due to low Islamic financial literacy, restricted institutional outreach, lack of stakeholder coordination, and the absence of risk mitigation tools such as agricultural *takaful*. To maximize the potential of Islamic finance, the study recommends improving financial literacy, strengthening BMTs and Islamic cooperatives, developing community-based financing models, and fostering synergy among stakeholders. With proper support and policy alignment, Islamic finance can play a key role in empowering farmers, enhancing food security, and promoting rural economic resilience.

Keywords: Islamic Finance, Agricultural Financing, Ponorogo, *Qardhul Hasan*, *Mudharabah*, *Musyarakah*

## 1. INTRODUCTION

Ponorogo Regency is one of the regions in East Java Province known as an agrarian area. The majority of its population relies on the agricultural sector for their livelihood, either as land-owning farmers or agricultural laborers. The abundant natural resources and supportive geographical conditions make agriculture the backbone of the local economy (Bromley & Cernea, 1989). Agricultural commodities such as rice, corn, and horticultural products are the main yields that support the community's livelihood and serve as a strategic sector in efforts to improve welfare and reduce poverty (Sunarmo & Majid, 2024).

However, the agricultural sector in Ponorogo still faces various complex challenges, particularly in terms of access to financing. The conventional financing system currently available is considered insufficient in addressing the needs of small-scale farmers due to strict requirements, burdensome interest schemes, and the lack of collateral that farmers can provide (Mubarok, 2021). As a result, many farmers continue to rely on middlemen or informal institutions, which carry high risks and significant economic burdens (Idris et al., 2025).

In this context, the presence of the Islamic financial system offers a more inclusive alternative that aligns with the socio-cultural values of the Ponorogo community, which is predominantly Muslim with strong religious traditions. Islamic finance, which is based on principles of justice, transparency, and partnership and is free from elements of usury (*riba*), gambling (*maisir*), and uncertainty (*gharar*), can provide a fairer and more sustainable financing solution (Khan et al., 2021). Islamic financial products such as *mudharabah*,

musyarakah, and qardhul hasan have the potential to empower farmers and strengthen rural economic resilience (Niswatin, 2025).

Despite its promising potential, there remains a gap in the literature and policy discourse regarding the practical implementation of Islamic financial products specifically tailored for the agricultural sector in rural areas like Ponorogo. Existing studies have mostly focused on the theoretical advantages of Islamic finance or its applications in urban and commercial settings, with limited attention to rural, agriculture-based economies. Additionally, there is a lack of contextualized financial models that consider local farming practices, seasonal income cycles, and community-level trust systems. These gaps highlight the need for focused research that explores the feasibility, design, and scalability of sharia-based financial products to meet the unique needs of the agricultural sector in this region.

Therefore, it is important to further explore the potential for developing Islamic financial products to support the agricultural sector in Ponorogo. This research aims to analyze the extent to which Islamic finance can be effectively implemented in agricultural financing, as well as to identify the opportunities, challenges, and future development strategies. The study also seeks to contribute to the formulation of inclusive financial instruments that bridge the financing gap for farmers while respecting local values and socioeconomic realities.

## 2. LITERATURE REVIEW

The integration of Islamic finance into the agricultural sector has gained increasing attention in academic and policy discussions, especially in Muslim-majority regions where conventional financial systems often fail to accommodate the socio-religious and economic realities of smallholder farmers. This section reviews existing literature across several thematic areas to build the theoretical foundation for the development of sharia-compliant financial products in Ponorogo's agricultural economy.

### 2.1. Islamic Finance Principles and Instruments

Islamic finance operates on the principles of risk-sharing, ethical investment, and the prohibition of interest (*riba*), speculation (*maisir*), and uncertainty (*gharar*) (Kuyateh, 2022). Instead of interest-based lending, it emphasizes profit-and-loss sharing contracts and asset-backed transactions. Common instruments relevant to agriculture include *mudharabah* (profit-sharing), *musyarakah* (joint venture), *murabahah* (cost-plus sale), *ijarah* (leasing), and *qardhul hasan* (benevolent loan). These instruments offer flexible and ethical alternatives to conventional credit schemes, especially for farmers who lack collateral or stable cash flow.

### 2.2. Challenges in Agricultural Financing

Agriculture is inherently high-risk due to factors such as climate variability, fluctuating market prices, and biological uncertainties (Khatri et al., 2024). In Ponorogo, as in many rural regions, smallholder farmers face difficulty accessing formal financial services due to lack of credit history, insufficient collateral, and irregular income patterns (Mubarok, 2021). As a result, many rely on informal lenders or middlemen, who often charge exploitative interest rates and reduce farmers' bargaining power (Idris et al., 2025). These structural issues necessitate financial products that are both accessible and designed with farmers' unique conditions in mind.

### 2.3. Islamic Microfinance and Rural Economic Empowerment

Islamic microfinance institutions (IMFIs), such as Baitul Maal wat Tamwil (BMT), have emerged as grassroots financial intermediaries that blend religious values with community-based trust networks (Nazirwan, 2015). Empirical studies have shown that IMFIs can increase financial inclusion and improve livelihood outcomes among rural populations when properly integrated with local needs and supported by capacity-building initiatives. In Indonesia, BMTs have become important actors in rural finance, yet their potential to systematically support the agricultural sector remains underexplored in academic research, particularly in the context of long-term financing, value chain development, and risk mitigation strategies.

### **3. RESEARCH METHODS**

This study employs a descriptive qualitative approach to provide an in-depth depiction of agricultural financing through Islamic finance in Ponorogo Regency. The data collection methods used include literature review, field observation, and in-depth interviews. The literature review was conducted to examine theories and previous research findings relevant to the topics of Islamic finance and agricultural sector financing (Snyder, 2019). Subsequently, field observations were carried out directly in several villages where the majority of residents work as farmers, in order to understand the real conditions related to access and practices of agricultural financing. To obtain more comprehensive primary data, in-depth interviews were conducted with various stakeholders, including farmers, administrators of Baitul Maal wat Tamwil (BMT) or Islamic Microfinance Institutions (LKMS), as well as representatives from local Islamic banking institutions. All data collected were then analyzed descriptively using a thematic approach, in which information was classified into key themes such as farmers' financing needs, the potential of Islamic financial products, implementation challenges, and product development strategies tailored to local characteristics.

### **4. RESULTS AND DISCUSSION**

Based on field observations and in-depth interviews with farmers, BMT/LKMS managers, and representatives of Islamic banks in Ponorogo Regency, several key findings were identified that form the basis of the analysis in this study.

#### **4.1. Agricultural Financing Conditions in Ponorogo**

Observations and interviews show that the majority of farmers in Ponorogo are still heavily dependent on personal capital and informal financing sources, such as middlemen and loan sharks. These financing schemes are often non-transparent and burden farmers with high interest rates and repayment schedules that do not align with the harvest cycle. Meanwhile, conventional financial institutions tend to be an unfavorable option due to administrative obstacles such as stringent collateral requirements, complex procedures, and inflexible loan tenors. This reality limits farmers' access to working capital, making it difficult for them to improve productivity or innovate in their farming practices. Dependence on informal financing models also increases the risk of social and economic inequality in rural areas (Ojeh et al., 2012).

#### **4.2. Opportunities for Islamic Financial Products**

Amid the limitations of conventional financing, Islamic financial products have begun to be introduced and have received positive responses from farming communities. Several BMTs (Islamic microfinance institutions) and Islamic cooperatives in Ponorogo have offered *qardhul hasan*-based financing, which is an interest-free loan and highly favored for short-term needs such as purchasing seeds, fertilizers, and pesticides. This product is considered more humane and suited to the economic conditions of small-scale farmers. Meanwhile, *mudharabah* (a profit-sharing partnership where capital comes from the BMT and expertise from the farmer) and *musyarakah* (a joint partnership between two or more parties) schemes are also being applied to land cultivation, plant maintenance, and harvest activities. These profit-sharing models are viewed as fairer, less burdensome due to the absence of fixed installments, and more appropriate for the fluctuating income of farming businesses. Grounded in the principles of justice, mutual assistance, and freedom from usury (*riba*), Islamic financial products hold great potential to be developed as an alternative financing solution for the agricultural sector (Bangash, 2020).

#### **4.3. Implementation Challenges**

Despite showing great potential, the implementation of Islamic finance in Ponorogo's agricultural sector still faces various challenges. One of the main issues is the low level of Islamic financial literacy among farmers. Many farmers do not yet understand the differences between Islamic and conventional financial products, nor are they aware of the long-term benefits of the Sharia-based system. In addition, the limited outreach of Islamic microfinance institutions (BMT/LKMS) also presents a challenge. Many remote villages still lack direct access to Islamic financial institutions, resulting in uneven product distribution. The lack of synergy between financial institutions, village governments, and farmer groups further worsens the situation (Shiferaw et al., 2008). In many cases, there is no coordinating platform to facilitate integrated financing planning for farming communities. Moreover, the absence of risk mitigation instruments such as agricultural *takaful*—Sharia-based

insurance against crop failure due to pests or extreme weather—creates a critical gap in protecting farming businesses. Without such protection schemes, the sustainability of Islamic financing becomes more vulnerable.

#### 4.4. Development Strategies

To address these challenges and maximize the potential of Islamic financing for the agricultural sector, a comprehensive set of development strategies is needed. First, improving Islamic financial literacy should be a priority. Training and mentoring programs involving academics, Islamic finance practitioners, and community leaders should be regularly conducted at the village level. Second, the empowerment of BMTs and Islamic cooperatives must be strengthened through capacity building, capital augmentation, and technological support to expand service reach. Third, it is important to develop community-based Islamic financing models, such as the formation of guided farmer groups that can access collective financing under the joint responsibility (*tanggung renteng*) principle to minimize credit risk. Finally, there must be synergy among authoritative bodies such as the Financial Services Authority (OJK), the Department of Agriculture, Islamic banks, and local governments to formulate Sharia-compliant financing products that are adaptive to farmers' needs and economically and socially sustainable. These initiatives not only contribute to the welfare of farmers but also strengthen food security and regional economic resilience.

## 5. CONCLUSIONS

The results of the study indicate that agricultural financing in Ponorogo Regency still faces considerable structural challenges. Most farmers rely on informal financing sources that are often detrimental, while access to conventional financial institutions is limited due to various administrative obstacles. In this context, Islamic finance emerges as a promising alternative. Products such as *qardhul hasan*, *mudharabah*, and *musharakah* are considered more suitable for agricultural activities as they offer fair, flexible, and interest-free schemes.

However, the implementation of Islamic financing is not yet optimal. Low levels of Islamic financial literacy, limited outreach of Islamic microfinance institutions, lack of institutional synergy, and the absence of risk mitigation instruments are the main hindering factors. Therefore, an integrated development strategy is necessary, including financial education, strengthening of BMTs and Islamic cooperatives, development of community-based financing models, and collaboration among stakeholders such as the Financial Services Authority (OJK), local governments, and Islamic financial institutions. Overall, Islamic financing holds great potential to improve equitable access to capital for farmers, strengthen food security, and promote sustainable rural economic development—provided it is supported by appropriate policies and effective implementation.

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