

Research Article

Strengthening Risk Governance Model of Islamic Microfinance Institutions Based on Maqashid al-Syariah (A Multi-Case Study of BMT Failures in Indonesia)

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Abstract: This study analyzes risk governance failures in Islamic Microfinance Institutions (LKMS) using the maqashid al-shariah framework, grounded in Auda's (2008) systems approach. A multi-case study was conducted at BMT Global Insani Cirebon, which recorded losses of IDR 77 billion, and BMT Mitra Umat Pekalongan, with losses of IDR 50 billion. Together, these cases represented 76% of total BMT losses in Indonesia during 2015–2024. Data were collected through in-depth interviews with eight key informants, document analysis, and direct observation. The findings identified three mutually reinforcing components of risk governance failure: weak institutional governance, unstructured risk identification, and unplanned risk mitigation. These weaknesses indicate inadequate integration of Islamic principles into institutional risk management practices. Based on the findings, a strengthening model was developed comprising three interconnected pillars: Institutional Legitimacy, Supervisory Epistemology, and Substantive Regulation. Each pillar is grounded in the dimensions of maqashid al-shariah and emphasizes institutional accountability, effective supervision, and regulatory compliance. The model provides a framework for strengthening risk governance and promoting sustainable, accountable, and Sharia-compliant LKMS.

Keywords: BMT; Islamic Microfinance Failure; Maqashid Al-Syariah; Multi-Case Study; Risk Governance.

1. Introduction

Sharia Microfinance Institutions (MFIs), especially Baitul Maal wat Tamwil (BMT), play an important role in the development of an inclusive financial architecture in Indonesia. As an institution that combines social (maal) and business (tamwil) functions, BMT serves a part of society that has been unreachable by conventional banks. By offering products based on sharia principles, including: wadiah deposits, mudharabah, murabahah financing, musyarakah, and qardh, BMT is an important part of the national inclusive financial ecosystem (Isfianadewi, 2024). BMT not only functions as a commercial financial institution, but is also responsible for realizing maqashid al-sharia, specifically wealth protection (hifdz al-mal) and the creation of economic benefits for its members and the surrounding community (Faiz Qadri Sahri Lubis & Khusnul Ashar, 2024). However, weak governance and risk management in many BMTs remain a serious threat to sustainability and public trust.

The great potential that BMT has must be watched out for because of its structural vulnerability. Data shows that the total losses due to BMT failures in Indonesia during 2015–2024 have reached more than Rp 200 billion. Documented cases show a recurring and consistent pattern: organized internal fraud, weak governance mechanisms, high-risk operational practices, and non-compliance with sharia principles as the basis of the institution (Sirotudin, 2024; Rahajeng, 2022). Similar conditions are also found globally. In Ghana, Sri Lanka, Zambia, and West Africa, microfinance institutions are failing due to a combination of ineffective regulation, poor governance, and problematic financing levels that exceed their critical limits (Siwale & Ritchie, 2011; Sumanasiri & Priyankara, 2020; Togba & Ntamack, 2019). This fact shows that the failure of the BMT is not just a technical operational problem, but reflects a systemic crisis in governance, oversight, and institutional risk management.

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Of the various cases that exist, there are two that are the focus of this research because both are very representative and significant in importance. First, BMT Global Insani Cirebon, which was declared bankrupt by the Commercial Court in March 2017, caused losses of up to Rp 77 billion due to the illegal qiradh hajj scheme that had been running since its inception (Novitasari, 2019). Second, BMT Mitra Umat Pekalongan which failed after 29 years of operation and gained the trust of the public, with losses estimated at Rp 50 billion (Buwono, n.d.). In total, these two cases accounted for approximately 76% of the total BMT losses during the period studied, making them the most representative study to understand the structure and causes of MFI risk governance failures in Indonesia.

A number of studies have examined the risk governance aspects of Islamic financial institutions from various perspectives (Jallali & Zoghلامي, 2022; Raouf & Ahmed, 2022; Aslam & Haron, 2021; Mutamimah et al., 2022). However, there is a significant conceptual shortcoming in the existing literature: there has been no research that specifically combines risk governance failure analysis with the maqashid al-sharia framework in the context of failed MFIs. This research aims to fill these shortcomings. Using the framework of the Auda (2008) system, which includes six main characteristics, namely openness (cognitivist nature), reflexivity, interconnectedness, hierarchy, multidimensional, and goal-oriented. This study proposes a model for strengthening the risk governance of MFIs that simultaneously have a strong managerial basis and a deep sharia justification.

The justification for choosing maqashid al-syariah as a framework of analysis is based on three main arguments. First, BMT has two mandates, namely financial sustainability and social-spiritual goals, which cannot be adequately analyzed with a risk management framework alone. Second, the documented failure of BMT is not just a technical failure, but a value failure that occurs due to the disconnect between the operational practices carried out and the fundamental objectives of sharia which should be the spirit of the institution. Third, the integration of maqashid facilitates the development of a model that focuses not only on risk mitigation, but also on value creation and social impact, dimensions that are inseparable from the institutional identity of BMT (Asutay & Harningtyas, 2015; Mergaliyev et al., 2021). Thus, the maqashid al-sharia approach is important because it allows the analysis of BMT failures to be carried out more substantively, not only on the financial and technical aspects, but also on the deviation of the values and objectives of the sharia institution itself.

2. Literature Review

Risk Governance in Islamic Financial Institutions

Risk governance is recognized as an important factor for the sustainability of Islamic financial institutions. Jallali & Zoghلامي (2022) show that risk governance functions as a mediator between corporate governance and the overall performance of Islamic financial institutions, where internal mechanisms have proven to be more decisive than external mechanisms. Raouf & Ahmed (2022) found that Islamic banks with distinctive governance structures and character are more resistant to crisis pressure than conventional banks. Srairi et al. (2022) confirms that the governance quality of Islamic banks is positively related to measurable risk-taking and operational efficiency, which is significantly influenced by the existence and effectiveness of the Sharia Supervisory Board (DPS).

In the context of MFIs in particular, Mutamimah et al. (2022) highlight the importance of an integrated risk management system and a responsive early warning system as a key factor in the sustainability of BMT. Aziza & Ülev (2023) show that MFIs in Indonesia and Turkey strive to meet the principles of sharia compliance, transparency, and accountability as part of their governance commitments. Rasel & Win (2020), through a systematic review, identified that board structure, CEO characteristics, audit quality, and ownership type are major themes in the global MFI governance literature. Most relevant to this study, Rahajeng (2022) reveals the ethical paradox in BMT Indonesia: Islamic values that should be the basis for operations are actually ignored in real practice, thus opening systematic loopholes for fraud and irregularities.

Maqashid al-Syariah Based on the Auda System as a Risk Management Framework

Maqashid al-shariah, or the main purpose of sharia, traditionally includes the protection of religion (hifdz al-din), life (hifdz al-nafs), reason (hifdz al-aql), heredity (hifdz al-nasl), and property (hifdz al-mal). This concept has been widely adopted as a framework for assessing the performance of Islamic financial institutions (Asutay & Harningtyas, 2015). Soediro & Meutia (2018) show that internal fraud acts in BMT not only violate the protection of property by misappropriating member funds, but also violate the principle of trust which is the basic value of Islam. Izaty et al. (2024) attribute weaknesses in governance to violations of hifdz al-

nafs and hifdz al-aql, where limited human resource competence and irrational decision-making are the root of the deep problem.

Jasser Auda (2008) developed the system approach in maqashid al-sharia with six main characteristics that distinguish it from the classical approach: openness to knowledge sources (cognitivist nature), reflexivity as the system's ability to evaluate itself, interconnectedness between elements in an organizational unit, hierarchy that allows the prioritization of goals, multidimensional in considering various levels of protection, and goal-direction as the orientation of the entire system. This approach provides a much more dynamic and operational framework than Al-Ghazali's static classification, making it more precise and relevant to analyze the systemic failures of modern financial institutions with complex characters. Mergaliyev et al. (2021) empirically prove that Islamic financial institutions that integrate maqashid into their governance and decision-making systems show consistently more resilient performance, especially in the face of external pressures.

Risk Identification and Mitigation in MFIs

Effective risk identification requires a systematic approach based on data that can be independently verified (Lam, 2014). Hopkin (2018) stated that failure in the risk identification stage is the root of all failures in the risk management chain. Without proper identification, all subsequent mitigation efforts become ineffective. Specifically at the MFI level, Puspitasari & Kasri (2023) found that the absence of a feasibility analysis before making financing decisions is the main predictor of the emergence of problematic financing in Indonesian MFIs. Wahyuni-TD et al. (2021) noted that institutions without an early warning system based on leading indicators experienced three times slower response times to problems than institutions that had adequate systems. Therefore, failure to identify risks in MFIs is not only an operational technical weakness, but also a starting point for an institutional crisis that systemically erodes the quality of financing, organizational resilience, and public trust.

In the risk mitigation dimension, Ginena (2014) classifies the risk of sharia non-compliance as a unique risk that has a multi-layered impact, not only on the financial dimension but also on reputation and spiritual aspects. Hanefah et al. (2020) emphasized that in a community trust-based MFI ecosystem, weak internal control and the risk of sharia non-compliance directly erode the trust of members that have been built for years. Iqbal & Mirakhor (2008) suggested takaful or sharia insurance as the mitigation instrument that is most in line with Islamic principles, because it uses a ta'awun (mutual support) mechanism that is in line with the value of collectivity in Islam. Swandaru & Muneeza (2022) confirm that weak sharia governance significantly and directly contributes to the occurrence of fraud in Islamic financial institutions. Thus, weaknesses in risk identification in MFIs not only reflect managerial failures, but also demonstrate the absence of institutional capacity to detect threats before they develop into crises that threaten the sustainability of the institution.

3. Proposed Method

This study uses a qualitative approach with a multi-case study design because it is suitable for understanding complex and contextual phenomena in their natural setting (Yin, 2009). The selection of the object of BMT that has failed is based on an epistemological principle in the Islamic scientific tradition: understanding the different types of failures is not to repeat them, but as a serious preventive measure to avoid similar mistakes in the future.

This research was conducted in two locations: BMT Global Insani in Cirebon, West Java, and BMT Mitra Umat in Pekalongan, Central Java. Data collection is carried out through three complementary ways. First, in-depth interviews with eight purposively selected key informants, including former management, former supervisory board members, former operational employees, members who suffered direct losses, and representatives of relevant supervisory authorities. Second, document analysis of annual financial statements, minutes of management and supervisory meetings, internal warning letters, and court decision documents. Third, observation of the physical and non-physical conditions of the location after the failure occurred. Triangulation of sources and methods is applied consistently to ensure the validity and reliability of the data obtained.

Data analysis follows three stages according to the procedure of Miles & Huberman (1992): data condensation, data presentation, and conclusion withdrawal and validation. The main framework of analysis is the system-based maqashid al-sharia (2008), which is used to interpret failure patterns and formulate relevant reinforcement principles. The validity of the data is strengthened by strategies, including member checking to validate interpretation, peer debriefing with academic colleagues to test the consistency of the analysis, and documented trail audits to maintain the transparency of the research process.

4. Results and Discussion

Failure Profile: Two Complementary Patterns

Before systematically analyzing the dimensions of failure, it is important to understand the contrasting characteristics of the two cases. BMT Global Insani showed structural failure from an early age, with fraud that was structured and deliberately hidden behind an Islamic investment scheme. On the other hand, BMT Mitra Umat shows a different but equally dangerous pattern: the gradual degradation of governance in institutions that previously had a very good reputation for almost three decades. The differences between these two cases provide a more complete insight into the various pathways that can lead to MFIs experiencing risk governance failures.

Table 1. Comparative Profile of BMT Failure Cases.

Aspects	BMT Global Insani Cirebon	BMT Partners of Pekalongan
Year of Establishment	2012 (business unit of the Surabaja Madani Cooperative, Cirebon)	1995 (founded by Pekalongan youth)
Failure Pattern	Fraud structured from the beginning: the illegal qiradh hajj scheme since its establishment	Degradation of governance: 29 years of trust institutions then suffered gradual failures
Loss Value	Rp 77 billion, declared bankrupt by the Commercial Court in March 2017	IDR 50 billion
The Root of the Main Problem	Operating without legal validity; investment without feasibility study; Ponzi scheme behind sharia contracts	Shift from solemn orientation to profit; Non-substantive DPS; Systematic manipulation of financial statements
Maqashid Dimension Violated	Hifdz al-mal (main), Hifdz al-din (false sharia claims)	Hifdz al-mal, Hifdz al-nafs (elimination of critical supervisors), Hifdz al-nasl (institutional sustainability)

Source: Primary data of interviews and documents, 2025

Risk Governance Failure: Five Mutually Reinforcing Dimensions

These findings identify five dimensions of governance failures that work simultaneously and reinforce each other, creating an ecosystem of failures that are very difficult to fix from within in the absence of significant external intervention.

First, there is a weak governance structure. Second, the institution shows four interrelated conditions: (1) operations without a valid and verified legal basis; (2) the dominance of the family structure that effectively eliminates the separation of functions between ownership, management, and supervision, which violates the Regulation of the Minister of Cooperatives Number 8 of 2023; (3) Annual Members Meetings (RATs) are often not held substantively, or are conducted with previously manipulated financial statements; (4) erosion of transparency that takes place gradually and systematically, until the correction mechanism no longer works. Mollah & Zaman (2015) emphasized that the effectiveness of MFI governance is highly dependent on an independent oversight mechanism that is structured and has real authority. McNulty et al. (2013) confirm that governance only provides real benefits if it is carried out substantially, not just an institutional ritual.

From these findings comes an important academic proposition: formal RAT forums but loss of substance may be more detrimental than the absence of a mechanism at all. This is because the pseudo-legitimacy it produces actually hinders outsiders from detecting irregularities early. This is an empirical contribution that has not been explicitly documented in the literature of Indonesian MFIs.

Second, dysfunction of the role of administrators and supervisors occurs consistently in four patterns. First, DPS is used only as a tool of institutional legitimacy without adequate access to information and authority. Second, administrators who had good intentions and gave written warnings were even removed from their positions. Third, critical DPS members are set aside through the engineering of the election mechanism. Fourth, there is a gradual degradation from the absence of DPS to a formal presence that loses all its effectiveness. According to Mollah & Zaman (2015), DPS is only effective if it has full access to operational information, independence from executive pressure, and firm authority to stop decisions that

violate sharia principles. Alhammadi et al. (2020) stated that DPS failure is the main factor in the failure of Islamic financial institutions in various parts of the world.

Third, ineffective internal control systems were found in the findings that identified four conditions that together created a control vacuum: (1) the absence of written and communicated risk management SOPs; (2) the financial recording system is not integrated so that reconciliation becomes difficult; (3) the absence of an active internal audit function; and (4) full reliance on external audits without the support of internal audits, so manipulation of aggregate-level reports is not detected. COSO (2017) defines internal control as a process that puts information integrity at the core. Wahyuni-TD et al. (2021) noted that Islamic financial institutions without an active internal audit function have a much longer irregularity detection time, providing greater room for losses to grow.

Fourth, inadequate risk measurement and monitoring often leads to failure. There are two main patterns: first, operations run without a risk measurement system at all, without risk exposure reports, regular NPF monitoring, liquidity positions, or capital adequacy assessments. Second, the measurement system does exist, but it is systematically manipulated so that real conditions are hidden behind seemingly healthy reports. The first pattern shows risk blindness due to a non-existent system, while the second pattern shows the blindness hidden behind the illusion of transparency—which is much more dangerous. Hoyt & Liebenberg (2011) proved that organizations with a comprehensive and integrity-managed risk measurement system can increase the average value by 20%.

Fifth, a fragile risk culture has three main patterns: (1) pure business orientation from the beginning without instilling a culture of prudence; (2) a shift from solemn to profit orientation that sacrifices the value of trust as an institutional identity; (3) the culture of silence that arises as a result of the systematic elimination of the warner. Sheedy & Griffin (2018) show that the unwritten norms of behavior formed by leadership exemplary have more influence on the quality of risk decision-making than even the most sophisticated written policies. Gordon et al. (2009) found that leadership's commitment to risk culture is the strongest contingency factor that determines the effectiveness of an overall risk management system.

From the point of view of maqashid al-shariah, these five dimensions of failure affect all aspects of protection simultaneously. Hifdz al-mal is disrupted when the wealth of members is managed without adequate accountability (QS. Al-Baqarah: 188). Hifdz al-din is violated when sharia identity is used as a tool of legitimacy without sufficient supervision (QS. Al-Anfal: 27). Hifdz al-aql is disturbed when personal interests dominate, closing the space for rational deliberation (QS. Ar-Rum: 41). Hifdz al-nafs was disturbed when those who carried out their moral obligations as warners were instead punished. Hifdz al-nasl faces a threat when an unstable culture of risk comes at the expense of the institution's sustainability for future generations. An-Nisa: 9).

Risk Identification Design Failures: Four Dysfunctional Dimensions

The conceptual proposition of this analysis states that the failure to identify risks in MFIs is due to interrelated four-dimensional dysfunction, not simply due to the absence of specific instruments or procedures. The four dimensions include: analytical feasibility, methodological consistency, institutional responsiveness, and alert channel protection.

First, the unstructured identification process is found in two contrasting patterns: first, the absence of an identification process at all, in which member funds are directly channeled 100% to investment projects without feasibility studies, market analysis, or employee involvement who understand the field conditions; second, the degradation of the previously effective and community-based process, including direct visits to the business site, Interviews with family and neighbors, as well as periodic verification of business conditions, become large-scale investment decision-making that relies only on the intuition of a handful of administrators with unlimited authority. Lam (2014) asserts that effective risk identification requires a systematic, data-driven approach that can be independently verified—a prerequisite that was completely ignored in both cases. Puspitasari & Kasri (2023) identified the absence of feasibility analysis as the strongest predictor factor of non-performing financing in Indonesian MFIs.

Second, the degradation of identification methods and techniques occurs. Initially, the application of the 5C principle was very strict and consistent in the early stages of operation, but this mechanism weakened when the financing committee only became a stamp approval function. The most critical and dangerous is the strict and careful double standard of analysis for unrelated external parties, but loose and full of exceptions for management-related parties. Ginena (2014) refers to conflicts of interest in affiliated party transactions as a first-level governance risk that requires independent procedures and supervision. Wahyuni-TD et al.

(2021) showed that the degradation of identification methodologies typically appears two to three years before the decline in portfolio quality, opening up opportunities for intervention if early warning systems are functioning well.

Third, failures in categorization and risk handling. Three risks have been identified explicitly and in writing but actively ignored by management: (1) liquidity risk due to the maturity gap between liabilities to members and invested assets, which are communicated in writing but are considered excessive and unrealistic; (2) the risk of conflict of interest arising from financing to a company owned by the management itself, formally reported but ignored without explanation; (3) portfolio concentration risk, which is presented complete with data and projections, but does not trigger any corrective response. Lam (2014) classifies liquidity risk as one of the three existential risks that most often cause financial institution failure. This condition violates a serious fiduciary duty because the manager is aware of the risk but chooses not to act.

Fourth, an unresponsive early warning system shows two main contrasts: first, an operational one that takes place without a warning system at all; second, a system that technically works, with three very specific written warnings delivered in one year, each supported by adequate data and analysis, but functionally useless because it is ignored, and the warning party is finally removed from position. Arena et al. (2010) identified three key components in an effective early warning system: reliable data collection, clear escalation criteria, and an organizational culture that values the delivery of information, even the unpleasant ones. Sheedy & Griffin (2018) showed that organizations that actively protect whistleblowers are able to detect problems four times faster than organizations that do not.

Risk Mitigation Development Failures: Four Critical Dimensions

First, unplanned mitigation strategies present a stark contrast between two conditions: first, the total absence of mitigation strategies, in which all member funds are allocated 100% to a single project without diversification, insurance, minimal liquidity reserves, or contingency plans; and second, the degradation of a strategy that was initially highly effective, which was able to keep the non-performing financing ratio below 5% for nearly two decades through six interoperable mechanisms strengthening, becoming a complete loss of strategy when the orientation of the institution shifts from solemnity to profit. Lam (2014) stated that an effective mitigation strategy must include four important components: a written and communicated pre-disaster plan, instruments that are appropriate to the risk characteristics, adequate implementation capacity, and periodic evaluation and updates. Hadith of the Prophet Muhammad PBUH: "Tie your camel first, then trust in it" (HR. Tirmidhi no. 2517) emphasizes that true tawakal never means ignoring the necessary efforts and mitigation measures.

Second, the failure of preventive and corrective approaches can be seen from four main conditions: (1) an entirely reactive approach without a structured prevention mechanism; (2) corrective mitigation that is counterproductive by giving unfounded promises to members who are becoming suspicious; (3) strong rejection of the recovery recommendations from regulators; (4) systematic manipulation of accounts as a substitute for mitigation, reduction of NPF ratio through diversion to unusual items, increase in capital adequacy through valuation of assets above fair value, and increase profitability through recording actual unearned income. COSO (2017) emphasized that response to regulator recommendations is the strongest indicator of leadership's commitment to sound governance.

Third, the failure to mitigate specific interrelated risks. Three mutually reinforcing failures were identified: (1) the unavailability of adequate liquidity reserves: all member funds were channeled 100% to investments, while the proposal to establish a reserve of at least 15% of the total funds was rejected on the grounds of lowering reported profitability; (2) the degradation of diversification from a pattern that was originally effective to an extreme concentration on one business sector and a group of affiliated parties; (3) Fundamental weaknesses in sharia compliance risk mitigation: Products promising fixed returns in contracts that should be entirely profit-sharing-based, are a violation of the very basic mudharabah principle. The most obvious institutional irony in these findings is that institutions that consistently claim sharia identity do not make use of takaful at all, which is a risk protection instrument that is theologically most aligned with Islamic values because it operates a ta'awun mechanism (Iqbal & Mirakhor, 2008).

Fourth, the degradation of mitigation instruments from community-based ones to ineffective formalities. Originally highly effective collateral instruments, in the form of household goods, combined with strong community social control, managed to keep non-performing financing at a very low ratio for nearly two decades. However, these instruments are degraded into formal property collateral that loses all of its protection value when used in

financing to an affiliated party that is practically unenforceable. Basiruddin & Ahmed (2020) found that MFIs that retained community-based mitigation instruments as a key component of their portfolios showed consistently better portfolio quality than those that switched entirely to formal instruments.

Model of Strengthening Risk Management of MFIs Based on Maqashid al-Syariah

The synthesis of thirteen dimensional constructs that have been successfully identified: five from the domain of governance, four from the domain of risk identification, and four from the domain of risk mitigation, results in an integrated reinforcement model that has an internal logic that is fundamentally different from each of its partial models.

The main proposition of this model is that MFI risk governance failures are tricomponent and interlocking: weak governance results in dishonest information-based decisions → risk identification cannot produce reliable outputs → mitigations cannot be proportionately designed → the protection gaps created worsen the quality of governance in subsequent periods. This negative feedback loop can only be effectively broken through simultaneous interventions on all three components at once.

Table 2. Model of Strengthening Risk Governance of MFI Based on Maqashid al-Syariah.

Pillar	Reinforcement Components	The Foundations of Maqashid al-Syariah
I. Institutional Legitimacy	Legitimate and verified operational legality; separation of ownership, management, and supervision functions; the uncompromising objectivity of pre-financing analytics; proportionality of protection in proportion to the member's risk exposure	Hifdz al-mal & Hifdz al-din
II. Epistemology of Supervision	Supervisory independence is institutionally protected; methodological consistency without double standards; institutional responsiveness to any alerts; Early warning channel protection as a prerequisite for the proper functioning of the other three components	Hifdz al-aql & Hifdz al-nafs
III. Substantive Regulation	Measurable performance standards that can be enforced, not just reporting compliance; the obligation to document the response to internal alerts; mitigation standards that are scalable according to the size of assets under management; periodic evaluation of the effectiveness of mitigation instruments	The integration of the fifth dimension of maqashid al-syariah

Source: Constructed from research findings, 2025

This reinforcement model is structured in three pillars that are cross-focus and operate at fundamentally different levels of intervention. Pillar I. Institutional Legitimacy operates at an internal institutional level, includes legitimate and verified operational legality, governance based on a clear separation of functions between ownership, management, and supervision, pre-financing analytical objectivity that cannot be compromised by affiliate interests, and proportionality of protection proportionate to the risk exposure borne by members. This pillar is justified by hifdz al-mal and hifdz al-din, members' property must be protected by legitimate and objective mechanisms, and sharia identity is only meaningful when operational practices reflect Islamic values substantively.

Pillar II. The epistemology of surveillance operates at the level of information quality in the system, including the independence of institutionally protected surveillance, methodological consistency with the same standards of analysis for all parties without exception, institutional responsiveness to any warnings conveyed, and the protection of warning channels as an absolute prerequisite for the functioning of the other three components. This pillar is justified by hifdz al-aql and hifdz al-nafs, that truly independent supervision requires a cognitive framework that is free from the pressure of interests, and that the truth-teller should be protected, not punished.

Pillar III. Substantive Regulation operates at the level of the external regulatory ecosystem, including measurable performance standards that can be enforced, not just formal reporting compliance, documentation obligations for responses to any incoming internal

alerts, mitigation standards that scale according to the size of assets under management, and periodic evaluations of the effectiveness of mitigation instruments used. This pillar is justified by the integration of the five dimensions of the maqashid, Regulations that are based on mere formal compliance and do not verify substance cannot manifest any of the five maqashids in real terms: they simply create a ritualism of supervision without substantive protection for the members.

The significance of this research goes beyond mere academic contributions. More than 4,500 BMTs currently operating in Indonesia manage collective assets estimated to be in the tens of trillions of rupiah, most of which belong to the lower strata who do not have access to alternative financial protection instruments. MFI failures are not just financial events, they are social trauma that destroys community trust, undermines the local economic order, and in many cases, leads poor families into a spiral of debt that is difficult to get out of. Building a robust, value-based, and operational risk governance system is one of the most important contributions that academics can make to the communities most in need of protection, and that is the fundamental motivation of this research.

5. Conclusions

This study analyzes the failure of risk management in BMT Global Insani Cirebon and BMT Mitra Umat Pekalongan using the maqashid al-sharia approach based on the Auda system (2008). The findings identified that failures were tricomponent and interlocking: (1) weak governance: including illegal structures, supervisory dysfunction, crippled internal controls, manipulated risk data, and fragile organizational cultures; (2) unstructured risk identification design: no feasibility study, degraded methods, actively ignored categorization, and unresponsive early warning systems; (3) Unplanned risk mitigation: without diversification, corrective responses are ineffective, instruments do not work, and takaful is completely ignored.

The resulting reinforcement model has three pillars that are cross-focus and operate at different levels: Institutional Legitimacy (internal level), Supervisory Epistemology (information quality level), and Substantive Regulation (external ecosystem level). All pillars are justified by the dimension of maqashid al-sharia, strongly emphasizing that the development of MFI risk governance is at the same time a managerial obligation that can be demanded professionally and a sharia obligation that can be accounted for spiritually.

The three main contributions of this study are: (1) understanding failure as a phenomenon consisting of three interrelated and interlocking elements, so that intervention in one area alone is not enough to produce lasting change; (2) describe the epistemology of supervision as a fundamentally different foundation from institutional infrastructure because it affects the quality of information used in decision-making; (3) integrating maqashid al-syariah as the basis that determines the success of the model, not just a normative element. Further research recommendations include testing this model on LKMS that have survived for a long time, developing quantitative measurement tools to assess the epistemological quality of surveillance, and examining the conditions that allow the simultaneous application of the three pillars in various institutional contexts.

Author Contributions:

M. Sholeh Wafie: Conceptualization, Methodology, Formal Analysis, Investigation, Writing—Original Draft, Writing—Review & Editing. Slamet: Supervision, Writing—Review & Editing, Validation.

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