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## **Sharia Banking's Profit Loss Finance in the Context of ASEAN Economic Community**

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### **Abstract**

The paper's aim is analyzing the problems of profit and loss sharing financing. It was conducted with literature and interviews on funding customers, Islamic bankers and entrepreneurs. The results show that profit oriented lack of trust in the abilities of partners, moral hazard, mismanagement and lack of sharia product information. In doing so, giving incentive for funding customers, incentive compatible constraint, involved effort in spiritual and intellectual expected may help small and medium enterprises to face ASEAN Economic Community.

### **Keywords**

*ASEAN Economic Community, profit and loss sharing financing, small and medium enterprises*

ASEAN economic community is a sharing community of Southeast Asia countries in creating economic acceleration. This agreement has created a trading access which threatens a country's stabilization economic condition. It will be a new challenge for the countries especially the ones in Southeast Asia to maximize their potential, Indonesia included. Indonesia is a potential market due to its largest population than any countries in Southeast Asia. Economic growth is a country success benchmarks which is slowing down for these last four years. Base on the *Badan Pusat Statistik* at the 3<sup>rd</sup> quarter of 2015 Indonesia economic growth is at 4.73%. This

number shows the deceleration compares to the same period in 2014.

Business sector role is needed to enhance Indonesia economic growth. Processing industry is the main contributor of Indonesia economic growth and it shows deceleration of second quarter 2015 at 20.87% to 20.41% at the third quarter 2015. This deceleration affects the 4% exports value deceleration. Base on *Badan Pusat Statistik* data, Indonesia exports value is decreasing at January – October 2015 period. It is dominated by processing industry with 70.89%. The data show business sector has important role in Indonesia economic growth.

*Sharia* banking is expected to have a role in supporting economic growth with contribution to businessperson. *Mudharaba* and *musharaka* profit loss sharing's financing is a financing type applied by *sharia* bank. This financing is more focusing in establishing real sector business productivity than consumptive need fulfillment. However, this finance is at minority part. *Murabaha* financing with trading principle is still dominating financing structure to this days with 59% distribution.

The balance of liquidity and profitability is the main topic in bank activities as intermediary institution. Profit loss sharing with the involvement of depositor, bank, and businessperson is considered high risk. Business creates trade off on profit for the shareholder at one side and responsible of the stakeholder at the other side. Profit loss financing products which is more excellence than other financing type is marginalized due to risk's threat. The identified problems are the low profit loss financing, related parties' expectation, and the offered solution which will be focus of this paper.

### **Profit Loss Sharing Financing**

*Sharia* bank as an intermediary institution has several products; profit loss sharing principle financing is one of them. This financing

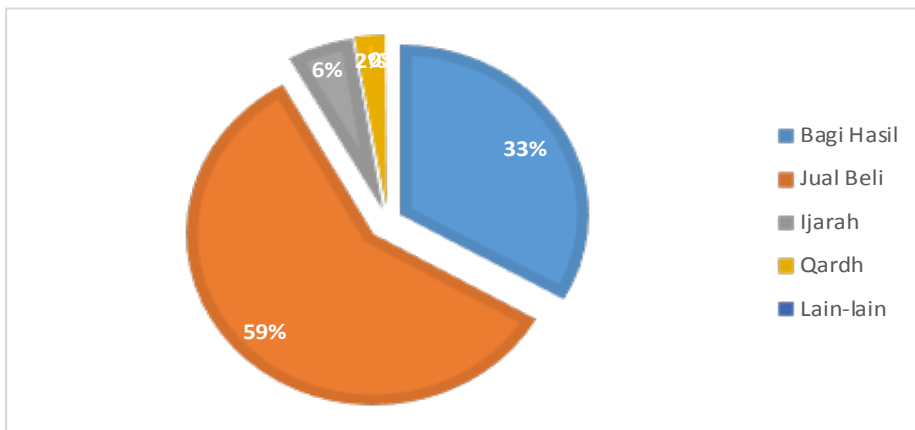
principle is in accordance in supporting real sector due to its ability to terminate the possibility of funding distribution for consumptive needs. It is a connector of skillful party and funding party enabling them creating productive business. This financing principle consists of financing with *mudharaba* and *musharaka* contract.

*Mudharaba* is a partnership contract of first party (*shahibul maal*) provides all modal (100%) and other party as the manager. The profit is divided according to agreement. The loss is borne by the modal owner for not the mistake of the manager. The loss due to manager's mistake is the responsibility of the manager. *Musharaka* is partnership contract with each party contributes fund and work with the agreement of profit and risk sharing (Antonio, 2001, p. 90)

Profit and loss are two inseparable things in business activities. According to Muhammad (2014), Islam acknowledges *al-Kharaj bi al-Dhaman* or *al Ghunmu bil Ghurmi* method. The method said that a person has to bear the risk in gaining profit of her investment. The profit has to be gained with sharing risk and compensation of the ownership. Profit loss sharing financing is considered high risk. The trade off between risk and profit is becoming difficult to predict therefore bank is changing into financing with profit assurance.

Profit loss financing in fact provides higher profit. Bank will gain higher profit with this financing due to the profit affected by the customer business income. The higher the customer business income will make higher bank's profit and the other way around. The businessperson is also helped due to freedom of certain amount payment. Therefore, profit loss sharing financing distribution is relatively small. Trading principle financing, especially *murabaha* is still dominating distributed financing products with 59%. The principle financing will give bank fixed profit. Therefore the financing customer should repay with fixed amount without

consideration the amount of the business profit.



*Sharia* Bank Distributed Financing Composition

Source: *Sharia* Bank Statistic

Profit loss financing is involving depositor customer as fund owner and bank as mediator and businessperson. The balance of expectation and challenge of each party is needed due to the high amount of profit loss sharing financing potential in helping business activities. Asymmetric information according to several literature is considered as the main factor which affects the low profit loss sharing. Asymmetric information is a condition which shows some investors with information and the others without information (Muhammad, 2014, p. 476).

According to Muhammad (2014), asymmetric information format is usually in moral hazard and adverse selection. The effort to minimize this risk in literature is named incentive compatible constrains. This method provides several restrictions for businessperson. They are larger modal or guarantee, business condition with low risk, cash distribution transparency and overhead expense cut. *Shari'ah* bank is expected to be able to minimize expense connection with asymmetric information with



screening and monitoring activities (Muda, 2011, p. 3).

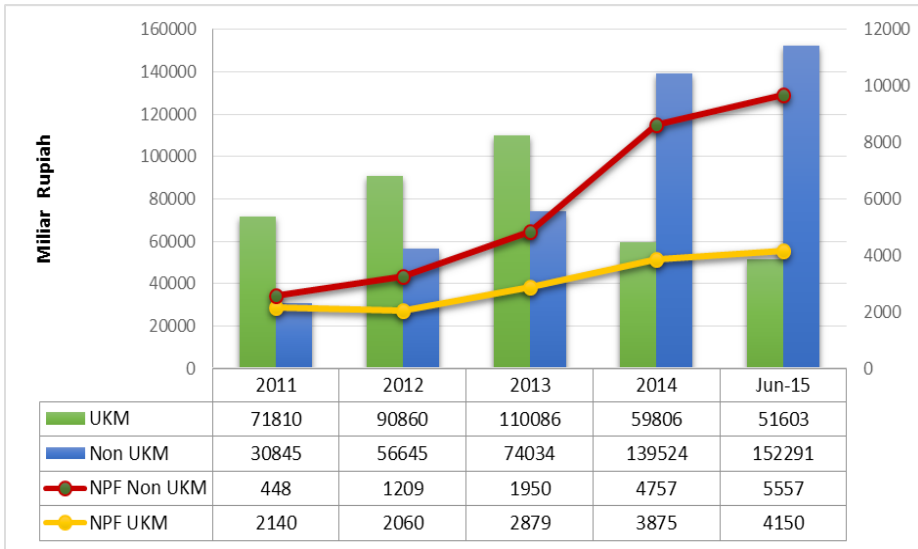
Ascarya (2011) divides the cause of low profit loss sharing financing into two factors, namely internal and external factor. Internal factor is related to human resource low quality and quantity, IT technical problem and SOP, and top management low commitment. The external factor is the low incentive and government regulation's support; and also society perception and trust. Muhammad Hanif (2010) does research on *musharaka* financing main obstruction factors in Pakistan are conventional bank, risk, profit manipulation, the lack of partner skill and trust, weak audit, conventional accountancy framework, and high tax. Khalil Rickwood and Murinde in Muhammad (2014) mentioned several bank consideration factors, namely businessperson reputation; businessperson experience and qualification; Islamic teaching obediency, project profitability, financial record, financial distribution position; project uncertainty level; social and environmental condition; profit time horizon; and asset security.

### **Small and Medium Business**

Base on Law No. 20, 2008, small business is a business with net worth of 50 millions to 500 millions excluding the land and business building, or has annual selling of 300 millions to 2.5 billions. Median business is a business with worth more than 500 millions to 10 billions excluding land and the business building, or with annual selling more than 10 billions to 50 billions.

Small and median business (UKM) in Indonesia have several benefits therefore the government is trying hard to develop this sector. The benefits are supporting economic growth; enhancing productivity; creating new technology, product, and service; creating market changes and competition; creating jobs; enhancing live quality; income distribution; sources mobilization and utilization to enhance national productivity;

and enhancing government prosperity with tax (Echdar, 2013, p. 23). The goals achievement has several obstructions. According to Nazaruddin (2014), the obstructions are low human resource quality; and also weak modal structure and market access. Small and median businesses have difficulties in accessing *sharia* bank modal due to small and median businesses high risk.

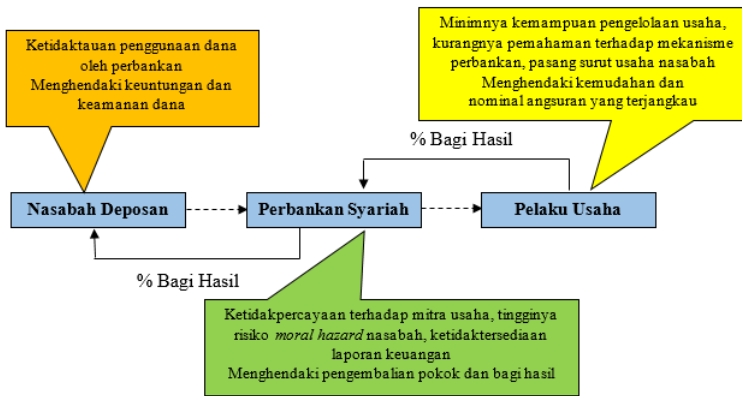


BUS and UUS Financing Based on Financing Type  
 Source: *Sharia* Bank Statistic

The data in this paper is gained of literature study with collecting reference books, journal, and interviews. The interviews are on direct and non-direct related to profit loss sharing financing distribution parties. The parties are bank management which consists of account officer and realtion officer; depositor customer who owns *mudharabah* saving; and businessperson. The field result will compare to the reference litertaures. The purpose is finding low profit loss sharing financing cause’s identifications

and expectation.

Sharia bank's profit loss sharing financing is involving three parties, namely sharia bank as intermediary institution, depository customer as modal owner, and businessperson as financing customer. Low profit loss sharing financing is affected by many factors. These factors identification is needed to create a strategy in the future. Therefore, expectation which is a desire to be achieved in a business activity needs to be attended.



### Identifying the Problems

	Masalah	Penyebab	Harapan	Strategi Minimalisasi
Nasabah Deposan	Orientasi pada keuntungan	Kurangnya pemahaman atas penggunaan dana nasabah	Keuntungan dan keamanan dana	Menjelaskan mekanisme penggunaan dana
				Pemberian insentif
Perbankan Syariah	Ketidakpercayaan terhadap mitra usaha	<i>Track record</i> pembiayaan bagi hasil yang buruk	Menghendaki pengembalian pokok dan bagi hasil	<i>Incentive compatible constrains</i>
		<i>Moral hazard</i> Ketidakterersediaan laporan keuangan nasabah		Pendampingan spiritual dan pendampingan intelektual
Pelaku Usaha	Pasar surut kondisi usaha	Minimnya kemampuan usaha nasabah	Menghendaki kemudahan dan nominal angsuran yang terjangkau	Menedukasi pelaku usaha pembiayaan – pembiayaan pada bank syariah
	Kurangnya pemahaman terhadap mekanisme perbankan	Minimnya informasi pembiayaan bagi hasil perbankan syariah		

Low Profit Loss Sharing Financing and Minimizing Strategy

The problem identifications of low profit loss sharing financing and its solving strategies in risk minimizing are some folds. Depositor customers save their money in the bank expecting profit and safety. The depositor customers usually do not know where they money will be entrusted by the bank. *Mudharaba* contract will make customer meets profit and risk. Therefore, the information should be delivered to the customers to avoid undesirable things in the future.

The problem is depositors usually accentuate profit. Customers who save their money in the bank have not yet ready for pure profit loss sharing concept application. The customers actually still need a certain security level of their fund (Ascarya, 2011, p. 217). Depositor customers fund withdrawal is bank main consideration in distributing profit loss sharing financing principle, due on the high risk of this financing principle. Bank applies revenue sharing as strategy to minimize depositor fund

withdrawal. This concept is determining profit loss sharing base on gross income before subtracted by bank operational expenses (Muhammad, 2011: 280). The expenses will be paid by the bank. Therefore bank is unwilling to use this high risk financing. Another effective method for the depositor customer and bank is initial intensive or certain nominal requirement financing as promotion.

*Sharia* bank as intermediary institution of excess-fund community and lack of fund community is facing tradeoff between the profit of profit loss sharing and social responsibility. It shows in the responsibility in financial distribution at profit loss sharing scheme and financing method which favors businessperson. The field research shows several things as a consideration for the bank to determine profit loss sharing. The problem is the banking sector distrust distrusts of its business partner. It is due to terrible track record financing, high risk moral hazard (dishonest customer), and unavailable customer's financial record. Moral hazard risk is the *sharia* bank main consideration in distributing profit loss sharing financing. The effort to minimize the risk in the literature is named incentive compatible constrains. It consists of larger modal portion policy or collateral enforcements; low risk business; and also cash distribution's transparency and overhead expenses cut.

Another method to minimize risk is business mentoring. It consists of two aspects namely spiritual and intellectual mentoring. Spiritual mentoring needs to be implanted in the fund manager customer. Religious foundation enhancement is the basic and self-control in avoiding deviant behavior (moral hazard) of the businessperson. The mechanism is proved to be effective in minimizing moral hazard high risk. Intellectual mentoring is also helping fund manager customer (businessperson) facing obstruction in the business. The mentoring will create partnership relation of customers and bank. Customer performance will be able to be closely

monitored and make the expected profit. The mentoring is also helping the availability of financial report. Financial report unavailability is not intentional. This is because the customer does not have the knowledge make a financial report.

According to Sixpria (2014) the accountancy application in UMKM refers to SAK ETAP has not yet implicated due to UMKM businessperson's accountant limited knowledge to apply proper accountancy process. There is no financial report format which gives convenience for UMKM in providing business real time information. A simple financial report should consist of cash flow, active, obligation, modal, income, and expense. It will help the bank in monitoring and observing. One of businessperson's obstacles is unstable business condition. This condition is affected by customer limited ability to manage the business. It will be the bank's consideration in distributing modal contribution to business sector. Bank, in practice, requires guarantee and minimum 3 years operation in accessing bank modal. Small and median businessperson needs convenience in bank transaction.

Profit loss sharing does not need fixed repayment. It is in accordance with customer income from her/ his business, therefore it will help the small and median business. Many businesspersons do not know this financing scheme therefore the requirement of this financing principle is low. Society incomprehension on the *sharia* bank offered financing scheme and mechanism creates assumption the similarity of *sharia* and conventional bank. This assumption needs to be corrected. Bank need to provide education for businessperson to avoid this incorrect assumption. This education is urgent due to profit loss sharing financing potential in helping Indonesia economics with the role of small and median business.

Profit loss sharing financing will enable bank to participate in business. Business mentoring will help businessperson to survive in

increasing intense competition. ASEAN economic community is the challenge for small and median business to survive in intense competition with other countries. Production quality enhancement with high competitiveness is needed immediately with modal contribution and business mentoring by *sharia* bank.

### **Concluding Remarks**

*Sharia* bank active role with profit loss sharing financing has large potential in helping small and median business economic activities to deal with ASEAN Economic Community. Profit loss sharing financing is involving three parties, namely depositor customer as modal owner, *sharia* bank as intermediary institution, and businessperson. Problems and expectations of each party are needed to be attended.

Depositor customer is oriented on fund safety and profit. It is due to customer incomprehension on fund's utilization mechanism by the bank. The strategy to solve this problem is explanation of fund distribution mechanism and incentive providing which will be able to maintain old customers and gaining new ones. The bank's problem is distrust aspect which could be solved with incentive compatible constraint and business mentoring (spiritual and intellectual aspect). Businessperson's problems are related to customer business instability and lack of knowledge about *shari'ah* bank financing products which will be able to minimize with business mentoring and bank products education. The offered strategies are expected to support bank in distributing profit loss sharing financing principle for the small and median business.

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