FINANCING RISK MANAGEMENT IN SHARIA FINANCIAL INSTITUTIONS

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# Abstract

# Management is the process of planning, organizing, directing, and controlling activities to achieve organizational goals effectively and efficiently by using organizational resources. Therefore, risk management is needed to identify, measure, monitor and control risks in accordance with sharia banking business activities. These steps are taken in order to mitigate risk by considering compliance with Sharia Principles. Risk is the potential loss due to the occurrence of certain events. Risk in the banking context is a potential event, both expected and unexpected, which has a negative impact on bank income and capital. Financing is funding provided by a party to another party to support planned investments, either by themselves or by institutions. In other words, financing is funding issued to support planned investments. The term financing basically means I believe, I trust, I believe, I put my trust. Islamic banks are banks that carry out business activities based on sharia principles, or Islamic legal principles regulated in the fatwa of the Indonesian Ulema Council such as the principles of justice and balance ('adl wa tawazun), benefit (maslahah), universalism (alamiyah), and do not contain gharar. , maysir, usury, injustice and unlawful objects.

***Keywords: Management, Risk, Financing, Islamic Bank***

# PRELIMINARY

Along with technological developments, the business world of financial institutions has undergone significant changes. Changes that occur indirectly have changed the characteristics of the risks faced by financial institutions. Two decades ago, financial institutions were basically only exposed to credit and market risks. But today, financial institutions are open to new forms of risk. (Iqbal and Mirakhor 2008). There are no more detailed provisions regarding banks conducting business activities based on sharia principles. The existence of Islamic banking has only gained a strong foundation since dated July 16, 2008 with the promulgation of Law Number 21 of 2008 concerning Sharia Banking, hereinafter referred to as the Sharia Banking Law.[[1]](#footnote-1)

Like conventional banks, Islamic banks also function as intermediary institutions, which function to collect funds from the public and channel these funds back to people who need them in the form of financing[[2]](#footnote-2). The classification of financial institutions in Indonesia includes Bank Financial Institutions and Non-Bank Financial Institutions. Sharia Microfinance Institutions such as Baitul Maal wat Tamwil (BMT) are a form of Non-Bank Financial Institutions. Institutionally, BMT is a Sharia Microfinance Institution with a cooperative legal entity that can operate based on Law no. 17 of 2012 namely as a cooperative of producers, consumers, services and savings and loans. (Joseph 2013)

The precautionary principle is regulated in health signs, among others, regulated in Article 23 and Article 36 of the Sharia Banking Law. On Article (1) The Sharia Banking Law stipulates that “Islamic Banks and/or UUS must have confidence in the willingness and ability of prospective Facility Recipient customers to pay off all obligations on time, before Sharia Banks and/or UUS channel funds to Facility Recipient customers” . To gain confidence, Islamic banks are required to conduct a careful assessment of the character, capacity, capital, collateral, and business prospects of the prospective customer receiving the facility (character, capacity, capital, collateral, condition)[[3]](#footnote-3).

In Article 36 of the Sharia Banking Lawstipulates that "In providing financing and carrying out other business activities, Islamic banks and UUS are obligated to take ways that are not detrimental to the Islamic bank and UUS and the interests of customers who entrust their funds", so that Islamic banks in providing financing must have confidence in the willingness and ability of the facility recipient customers. The legal relationship of Islamic banks with customers is based on the principle of trust. It is not limited to belief based on good faith but also belief based on the value of monotheism that what is done is always supervised by Allah swt, so that every action taken is worship, so that the purpose of Islamic banking is not solely profit oriented. ) but also seek prosperity in the world and happiness in the hereafter (falah oriented). Sutan Remy Sjahdeini formulated that the purpose of implementing the precautionary principle is none other than so that banks are always in a healthy condition, so that, among other things, always in a liquid, solvent and profitable (profitable).Burhanuddin Susantoemphasizes that Islamic banking must always maintain public trust both from the financial and financial aspects In Islamic banks to assess whether or not the proposed financing is generally used "three pillars of philosophy" and 5 C's principles. The philosophy of the three pillars of customer business feasibility, namely:

1. Management credibility which includes honesty, good faith key person from customer/character and ability to manage business key person/capability.
2. The ability to repay (repayment capacity) which includes the ability of the customer's business to generate profits from the products and services carried out by the customer and management of the customer's business cash flow in the past (historical cash flow) including projected cash flow in the future is a the primary measure of a customer's ability to repay payments.
3. The collateral submitted is analyzed regarding the resale price of the collateral, the ease of selling the collateral and the completeness and validity of the collateral documents.

Preventive efforts carried out by Islamic banks before providing financing to customers, namely by analyzing the 5 Cs, namely: *Character*: assessment of the customer's character is to determine the good faith of the customer to fulfill his obligations (willingness to pay) and to know the moral, character and personal characteristics that are positive and cooperative. Character is a dominant and important factor because even though the prospective customer is capable enough to settle his debt, if he does not have good intentions, it will certainly bring various difficulties for the bank in the future. An overview of the character of the prospective customer can be obtained through the following efforts:

1. Examining the curriculum vitae of the prospective customer;
2. Verify data by conducting interviews;
3. Researching the reputation of the prospective customer in the business environment
4. Bank Indonesia checking and requesting information between banks;

Seek information or trade checking with business associations where potential customers are located;

1. Looking for information about the lifestyle and hobbies of potential customers. *capacity,*namely the customer's ability to run a business in order to obtain the expected profit so that it can return the financing received, to measure capacity it is done through various approaches, namely:
2. Historical approachnamely assessing past performance whether it shows progress from time to time (at least the last 2 years).
3. professional approach,namely assessing the educational background of the administrators. This is especially important for companies that require high-tech expertise or companies that practice high professionalism.
4. juridical approach,that is juridically whether the prospective customer has the capacity to represent the business entity he represents to enter into a financing agreement with the bank.
5. managerial approach,namely assessing the ability and skills of customers to carry out management functions in leading the company.
6. technical approach,namely assessing the ability to manage production factors such as labor, sources of raw materials, equipment/machinery, financial administration, industry relations to the ability to seize the market.

*Capital*is to assess the amount of own capital invested by the customer in his business, including the ability to increase capital if needed in line with the development of his business. *conditions,*namely the customer's business condition which is influenced by the social and economic situation. Conditions are influenced by, among others, government regulations, the situation, politics and the world economy, economic conditions that affect marketing, products and finance. *collaterals,*namely assets or objects that are handed over by customers as collateral for the financing they receive. The collateral must be assessed by the bank to determine the risk of the customer's financial obligations to the bank. The assessment of the guarantee includes the type, location, proof of ownership and legal status. The assessment of the collateral can be viewed from two aspects as follows:

1. economical point of view, namely the economic value of the object to be pledged.
2. juridical aspect, namely assessing whether the collateral meets the legal requirements to be used as collateral.

The 5 C principle is sometimes added to another 1 C, namely constraintor obstacles that might interfere with the business process. One of the important elements of the 5 C principle is the presence of collateral. The presence of collateral is very important in financing because the funds used by Islamic banks in the context of distributing funds are depositors/investor customers, so that the presence of collateral is to guarantee the repayment of financing in the event of non-performing financing. Islamic banks in providing financing are required to take ways that do not harm the bank and the interests of its customers who have entrusted their funds. In addition, there is also an obligation for every Islamic bank to continue to maintain its health and maintain the public's trust in it.

According to Muhammad Syafii Antonio, the purpose of the financing analysis is to convince the bank that the requested financing is feasible and trustworthy and is not fictitious. A financing will not be approved before certain main things are confirmed, namely:

1. Is the object of financing halal or haram?
2. Will the project cause harm to the community?
3. Is the project related to immorality?
4. Is the project related to gambling

According to Muhammad there are several approaches to financing analysis carried out by Islamic bank managers, namely:

1. **Guarantee approach**, meaning that the bank in providing financing always pays attention to the quantity and quality of the guarantee held by the borrower.
2. **Character approach**, meaning that the bank pays close attention to the character of the customer.
3. **Repayment capability approach**This means that the bank analyzes the customer's ability to pay off the amount of financing taken.
4. **Approach with feasibility study**This means that the bank pays attention to the feasibility of the business run by the borrowing customer.
5. **Approach to bank functions**meaning that the bank pays attention to its function as a financial intermediary institution, namely regulating the mechanism of funds collected with channeled funds

Likewise, stated by Sutan Remy Sjahdeini that financing analysis is needed so that Islamic banks gain confidence that the financing provided can be returned by customers. Basically there are 2 (two) aspects analyzed:

1. Analysis of willingness to pay is called qualitative analysis (willingness to repay). Aspects analyzed include the character and commitment of customers
2. Analysis of the ability to pay is called quantitative analysis (ability to repay). The approach used is to determine the ability to pay and the calculation of the customer's business capital needs is the net income approach.

In general, financing carried out by Islamic banks is only given to customers who receive facilities that already have a developing business, in the sense that financing will not be given to businesses that are just developing. Another caution is that the financing provided by Islamic banks must be stated in the form of a written agreement. This is as confirmed in Law Number 7 of 1992 concerning Banking as amended by Law Number 10 of 1998, namely in Article paragraph 2 and its Elucidation, which is formulated as follows: “Commercial Banks are required to have and apply credit and credit guidelines. financing based on Sharia Principles, in accordance with the provisions stipulated by Bank Indonesia”, and the explanation, as formulated as follows: ”The main provisions stipulated by Bank Indonesia include but are not limited to: a. The provision of credit or financing based on sharia principles is made in the form of a written agreement". Referring to the explanation of Article 8 paragraph 2 of the Banking Law, in the practice of Islamic banking, the provision of financing must be stated in a written financing agreement, because it is related to its function as evidence for the parties who make it.

If the financing has been approved by the Islamic bank and enjoyed by the customer receiving the facility, the role of the Islamic bank is heavier than when the funds have not yet been disbursed in the hands of the customer receiving the facility. To avoid the occurrence of financing failures, Islamic banks must conduct guidance and regular monitoring, namely by means of active monitoring and passive monitoring. Active monitoring, namely visiting customers regularly, monitoring financial reports regularly and providing customer visit reports/call reports to the financing committee/supervisor, while passive monitoring is monitoring payment of customer obligations to Islamic banks at the end of each month. At the same time, coaching is provided by providing advice, information and technical guidance aimed at avoiding financing failures.

Article 38 of the Sharia Banking Law stipulates that Islamic banks and UUS are required to implement risk management, the principle of knowing customers and customer protection. In the explanation, the definition of risk management is given:a series of procedures and methodologies used by banks to identify, measure, monitor, and control risks arising from bank business activities. Implementing regulationsregulated in Bank Indonesia Regulation Number 13/23/PBI/2011 concerning the Implementation of Risk Management for Islamic Commercial Banks and Sharia Business Units, it is explained thatwhereas sharia banking business activities cannot be separated from risks that can disrupt the continuity of the bank because sharia banking products and services have distinctive characteristics so that risk management is needed to identify, measure, monitor and control risks in accordance with sharia banking business activities. The steps taken by Islamic banks in the context of mitigating risks must consider compliance with Sharia Principles.

According to Zainul Arifin, management is a good and correct management method, to avoid mistakes, mistakes and uphold the truth. Upholding the truth is God's method that humans must obey. Thus management compiled by humans

to uphold the truth becomes obligatory.Management in Islam relies on the ijtihad of the leader and his people, provided that it must not conflict with basic concepts and legal principles derived from the Qur'an and hadith. The Messenger of Allah said in a hadith narrated by At-Thabrani:

*"Indeed, Allah really loves people who when doing a job, it is done in an itqan (precise, directed, clear and complete) manner.*HR. Ath-Tabarani. "If a matter is handed over to non-experts, then wait for the moment of its destruction." (HR Bukhari)

Islamic banks as Islamic financial institutions in their business activities on the one hand are trying to make profits but on the other hand must pay attention to the possible risks that arise in their activities. Specifically, the risks faced by Islamic banks include liquidity risk, credit risk18 (financing), operational risk, legal risk, reputation risk, strategic risk, compliance risk, fee-for-service risk, investment risk, while interest risk Islamic banks do not face as faced by conventional banks.

In Article 1 number 7PBI Number13/23/PBI/2011 concerning the Implementation of Risk Management for Islamic Commercial Banks and Sharia Business Units, which what is meant by credit risk isCredit Risk is the risk due to the failure of the customer or other party to fulfill obligations to the Bank in accordance with the agreed agreement. The financing risks faced by Islamic banks ,namely the risk that losses arise due to the customer's failure/inability to fulfill obligations according to the contract or agreement that has been established between the Islamic bank and the customer. Financing risk generally stems from the customer's character, customer capability and business cycle. These risks can have a greater impact on Islamic banks, so financing risks must be identified, measured, monitored and controlled[[4]](#footnote-4).

According to Adiwarman Karim20, the target of risk management policy is to identify, measure, monitor and control the course of bank business activities with a reasonable level of risk in a directed, integrated and continuous manner, so that risk management functions as a filter or early warning system for bank business activities. . The objectives of risk management itself are as follows:

1. Provide information about risks to regulators.
2. Ensure that the bank does not experience unacceptable losses.
3. Minimizing losses from various uncontrolled risks.
4. Measuring exposure and risk concentration.
5. Allocating capital and limiting risk[[5]](#footnote-5).

Risk management in Islamic banks has a different character from conventional banks, mainly because of the types of inherent risks that only exist in Islamic banks. The basic difference between Islamic banks and conventional banks lies not in how to measure (how to measure), but in what is assessed (what to measure). This difference can be seen in the operational risk management process of Islamic banks which include:

Risk identification, risk assessment, risk anticipation and risk monitoring.21 This is due to the characteristics of sharia banking business activities which are based on various principles in collecting funds, distributing funds and providing services. The risk identification carried out by Islamic banks does not only cover the various risks that exist in banks in general, but also includes the typical risks that exist only in Islamic banks. This is because of the uniqueness of the Islamic bank, there are six uniqueness, namely:

1. **Financing transaction process**. The characteristics of Islamic banks in this process can be seen in at least three aspects, namely the sharia financing transaction process, the transaction process for profit sharing from third party funds and the foreign exchange transaction process.
2. **Process management**. The uniqueness of Islamic banks in the management process can be seen in the accounting operational systems and procedures.
3. **Human Resources**. The uniqueness of Islamic banks in human resources can be seen in the specification of capabilities that do not only cover the banking sector in general but also cover sharia aspects.
4. **technology,**The uniqueness of Islamic banks in the field of technology can be seen in the Business Requirement Specification (BRS) for profit-sharing-based financing and the Business Requirement Specification (BRS) for third party funds.
5. **External environment**, the uniqueness of Islamic banks in this regard can be seen in the existence of a dual regulatory body, namely Bank Indonesia and the National Sharia Council.
6. **Damage**, the uniqueness of Islamic banks in terms of, for example, when there is damage to the object of ijarah or Ijarah Muntahiya Bittamlik[[6]](#footnote-6).

The financing risk faced by Islamic banks is related to other risks, namely Market Risk is the risk in the balance sheet and off balance sheet positions due to changes in market prices, including risk in the form of changes in the value of assets that can be traded or leased. Risk Liquidity is Risk consequence inability Bank for fulfill obligations that are due from cash flow funding sources and/or high quality liquid assets that can be used as collateral, without disrupting the activities and financial condition of the Bank. Operational Risk is the risk of loss caused by inadequate internal processes, failure of internal processes, human error, system failure, and/or external events that affect the Bank's operations[[7]](#footnote-7).

Legal Risk is Risk due to lawsuits and/or weaknesses in the juridical aspect. Reputational Risk is a risk due to a decrease in the level of stakeholder trust originating from negative perceptions of the Bank. Strategic Risk is Risk due to inaccuracy in making and/or implementing a strategic decision and failure to anticipate changes in the business environment[[8]](#footnote-8). Compliance Risk is the risk that the Bank does not comply with and/or does not implement the applicable laws and regulations, as well as Sharia Principles. Return Risk23 (Rate of Return Risk) is the Risk due to changes in the rate of return paid by the Bank to customers, due to changes in the rate of return received by the Bank from disbursing funds, which may affect the behavior of the Bank's third party fund customers. Investment Risk24 (Equity Investment Risk) is the risk as a result of the Bank participating in the loss of the customer's business which is financed in profit-sharing based on profit and loss sharing. Return Risk23 (Rate of Return Risk) is the Risk due to changes in the rate of return paid by the Bank to customers, due to changes in the rate of return received by the Bank from disbursing funds, which may affect the behavior of the Bank's third party fund customers[[9]](#footnote-9).

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For example, Islamic banks are obliged to comply with existing regulations, both internal and external, such as the following:

1. Minimum statutory reserve requirements, maximum limit for granting financing.
2. Provisions in providing financing.
3. Provisions in reporting to Bank Indonesia.
4. Tax provisions.
5. Terms in the contract.

**Fatwa of the National Sharia Council (DSN).**

If Islamic banks ignore the provisions in providing financing, it will have an impact on financing risk, namely the emergence of non-performing financing. Likewise, if Islamic banks ignore compliance with the DSN fatwa, it will have an impact on the reputation risk of Islamic banks. The application of sharia principles in the business activities of sharia banks must be carried out consistently so that there is no negative assessment of the implementation of sharia principles because a negative assessment of the implementation of sharia principles can result in negative publications so that it will increase the level of reputation risk[[11]](#footnote-11).

The impact of operational risk which includes reputation risk, compliance risk, strategic risk, investment risk, legal risk and others can be in the form of:

1. Massive withdrawal of third party funds.
2. There is a liquidity problem.
3. Permit revoked by Bank Indonesia.
4. Bankruptcy.

That if Islamic banks are not careful in managing these risks, the consequences will have an impact on the health of Islamic banks, which in the end does not rule out the possibility that Islamic banks will have liquidity problems and result in decreased public confidence so that people will withdraw their funds simultaneously, if this is the case. occurs, it will greatly affect the existence of Islamic banks. Bank Indonesia will try to rehabilitate Islamic banks, however, if the efforts made are not successful, Bank Indonesia's last resort26 is to revoke the business licenses of Islamic banks[[12]](#footnote-12).

**CONCLUSION**

Management is the process of planning, organizing, directing, and controlling activities to achieve organizational goals effectively and efficiently by using organizational resources. Therefore, risk management is needed to identify, measure, monitor and control risks in accordance with sharia banking business activities. These steps are taken in order to mitigate risk by considering compliance with Sharia Principles. Like conventional banks, Islamic banks also function as intermediary institutions, which function to collect funds from the public and channel these funds back to people who need them in the form of financing. The classification of financial institutions in Indonesia includes Bank Financial Institutions and Non-Bank Financial Institutions. Sharia Microfinance Institutions such as Baitul Maal wat Tamwil (BMT) are a form of Non-Bank Financial Institutions. Institutionally, BMT is a Sharia Microfinance Institution with a cooperative legal entity that can operate based on Law no. 17 of 2012 namely as a cooperative of producers, consumers, services and savings and loans.

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