

# THE ROLE OF ISLAMIC FINANCE IN SUPPORTING MICROENTERPRISES AND SMEs AGAINST COVID-19

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## CASE STUDY - INDONESIA

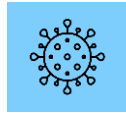
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# INTRODUCTION

# Aim, Objectives, and the Scope of the Study



## COVID Case

As of March 2021, 117 M confirmed cases & 2.6 M deaths  
268 M vaccine doses have been administered (WHO, 2020)



## Impact on Economy

4% contracted growth in 2020  
Projecting of 4.2% in 2021; 3.7% in 2022 (OECD, 2021)



## Impact on MSMEs

One of the most influenced sectors by them are informal and formal MSMEs



## Islamic Finance

PLS and risk-sharing and the presence of integrated Islamic social finance institutions make Islamic finance a significant vehicle to support MSMEs



## Aims

To analyse and reveal the policy responses  
To investigate the potential role  
To reveal the role of Islamic finance  
To provide policy recommendations

# Political Economy of COVID-19

## Impact on Economy

- Declining business cycle.
- Expansionary monetary (such as liquidity easing) and fiscal policies (such as payment for furloughed labour and MSMEs),
- Extensive borrowing by governments from the financial and capital markets

## Increase in Inequality

- Due to the decline of wage earners, while the capital owners increased their share in wealth

## Powered Financial Market

- Decline of returns from financial investments
- Non-performing loans is the essential issue

## Condition of MSMEs

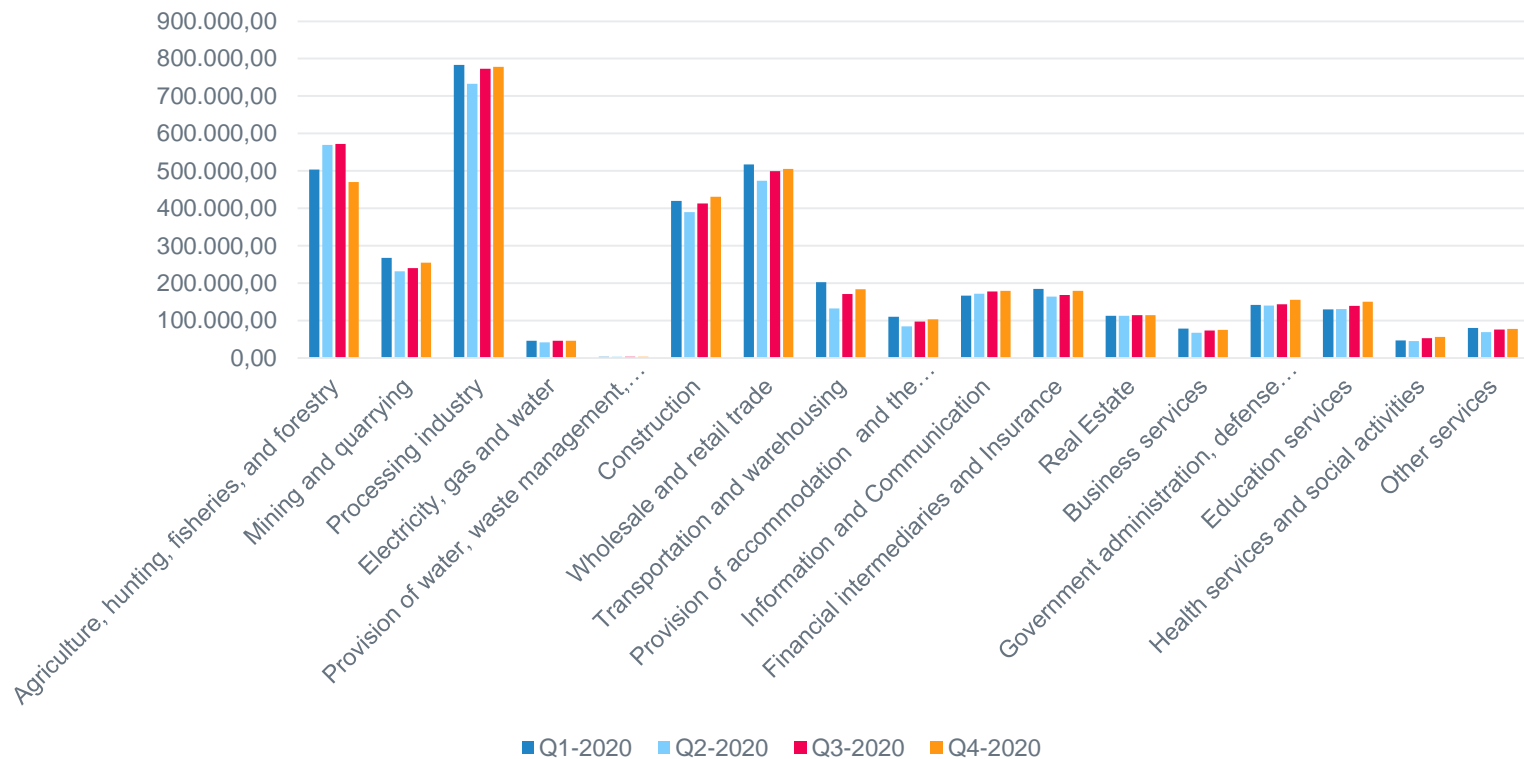
- Suffered enormously
- Insufficient financial support

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# CASE STUDY: INDONESIA

**The Country in Brief**

# Economic Structure



# Definition and Characteristics of MSMEs

Characteristics	Micro	Small	Medium
Net wealth	Maximum IDR 50 million	IDR 50-500 million	IDR 500 million-10 billion
Annual revenue	Max. IDR 300 million	IDR 300 million-2.5 billion	IDR 2.5-50 billion
Type of products	Not permanent	More stable	Stable
Place of business	Not permanent	Permanent	Permanent
Financial bookkeeping	Not yet	Simple	Clear accounting procedure
Separating financial business and family	No	Yes	Yes
Spirit of entrepreneurship	Low	Medium, shown by not yet conducting planning part	High, shown by clear task division
Level of education	Low	Medium	Educated
Access to financing	Non-bank financing	Bank and non-bank	Bank and no-bank
Legality	Mostly no	Yes	Yes
Example	Sellers in traditional market, food stall	Wholesaler, distributor	Stone mining for construction and artificial marble

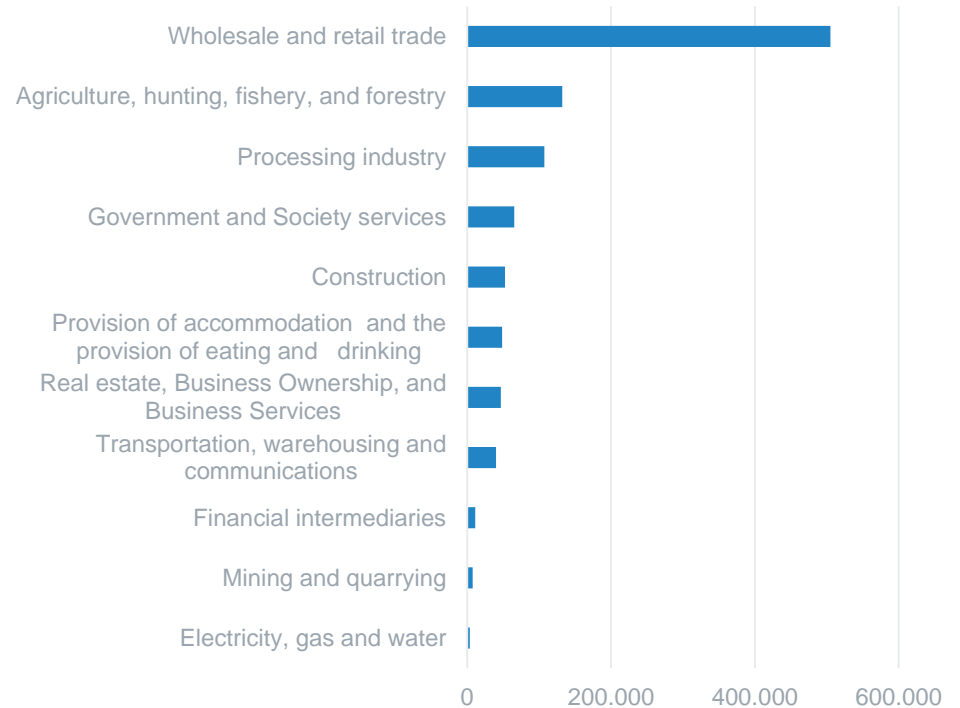
# The Role of the MSME in the Indonesian Economy

➔ **64 million**  
Units of MSMEs

➔ **2,045 T**  
Export value

➔ **61%**  
of GDP

➔ **121 million**  
people employed





3.

# CASE STUDY: INDONESIA

**Empirical Explorations**

# Financing Sources for the MSMEs and the Financing Gap in Indonesia

**1 'Kredit Usaha Rakyat'**  
Particularly intended for providing loans for MSMEs

It can be accessed by MSMEs directly through banks appointed by the government or through cooperatives/microfinance channeling from the designated banks

**2 PBI No.17/12/PBI/2015**  
Issued by the central bank, suggesting commercial banks to allocate their loan for MSMEs at minimum of 20% from their total credit.

If the bank could not reach it, they are required to provide training classes for the MSMEs

**3 Ultra-micro loan for MSMEs**  
For the unbankable, the loan capped at maximum of IDR 10 million

It is distributed through non-bank financial institutions appointed by the government

**4 Bank**  
It provides credit for working capital (around IDR 700 trillion) and investment (around IDR 280 trillion)

**5 Non-Bank**  
Through cooperatives, financing companies, venture capital  
Accounted for around 20-30% of total credit provided by non-bank institutions

# Challenges Faced by MSMEs During the Pandemic

## Sales

Lower purchasing power  
The implementation of health protocol  
The decline in physical interaction

## Operational

The productivity of employees  
Difficulty in predicting the demand  
Hindrane from the health protocol

## Supply

Price instability  
Longer delivery time  
Difficulty in finding a supplier

## Funding

Difficulty in getting financing/cash flow  
Customers are unable to pay or there is a delay  
Difficulty in repaying the existing loan

## Sectors Most Impacted

Accommodation and Food-Beverages

Other services

Transportation and Warehouse

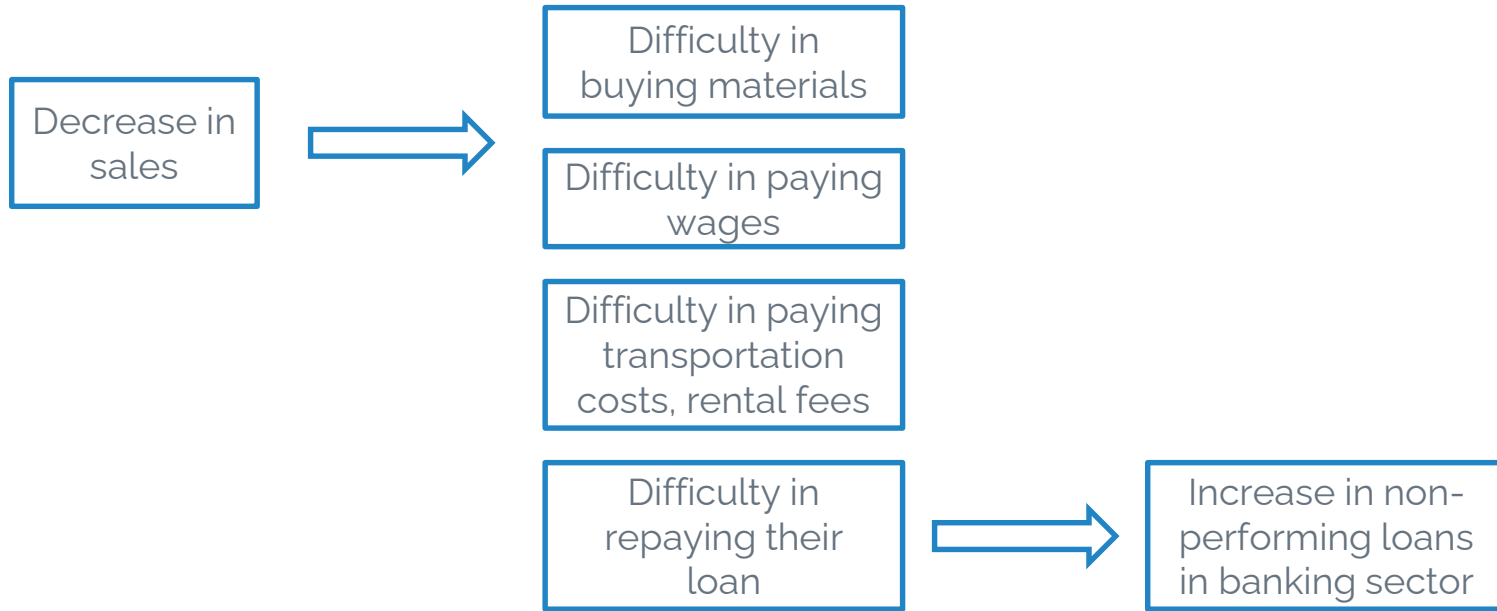
## Sectors Have Lower Impact

Water and waste management

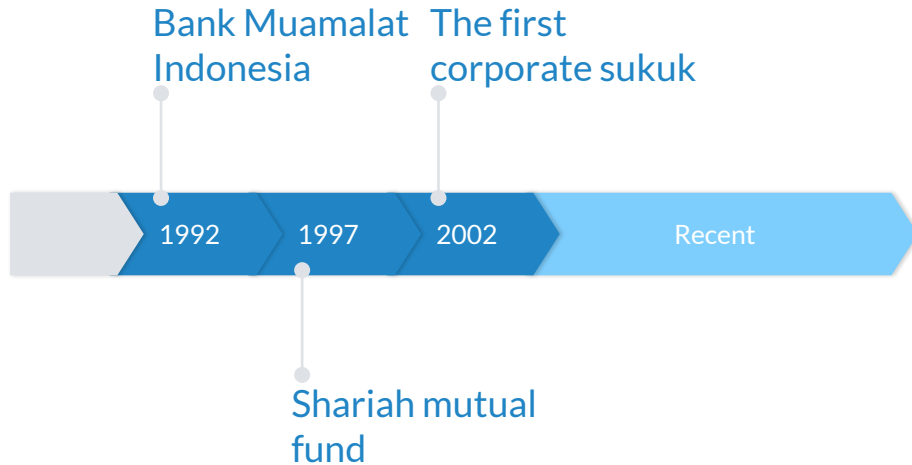
Electricity and gas

Real estate

# The Nature of Financial Challenges faced by MSMEs under the COVID-19



# The Trajectory of Islamic Finance: Institutionalization, Legal and Regulatory Framework, and Financial Standing



**14**  
Islamic Banks

**20**  
Islamic windows  
For the conventional banks

**163**  
Islamic rural banks

**13**  
Islamic insurance

**9**  
Islamic financing companies  
Including financing companies, venture capital, and infrastructure financing

**10**  
Islamic fintech

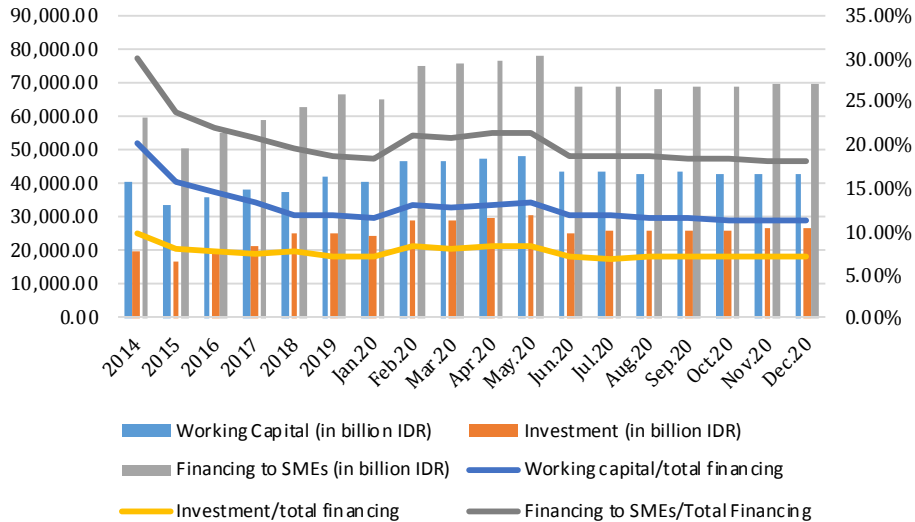
**4**  
Islamic pension fund

**80**  
Islamic microfinance

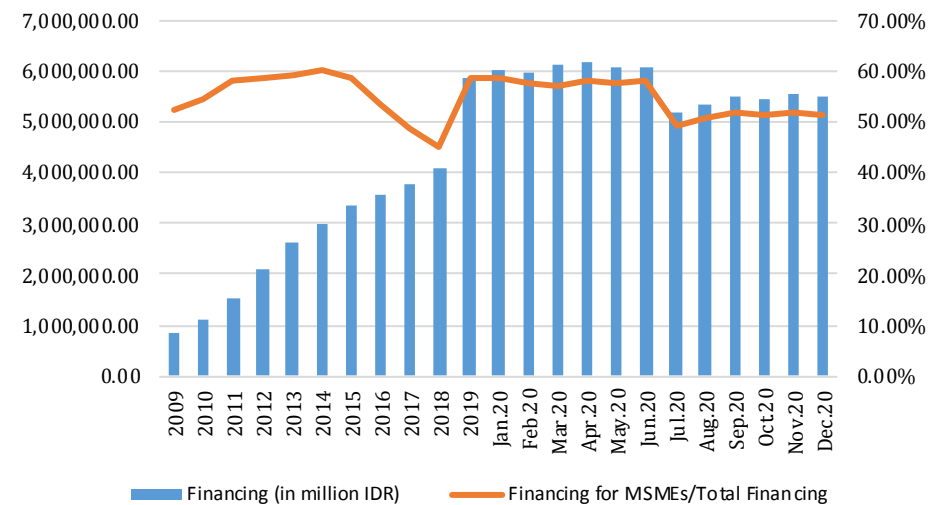
**5**  
Islamic specialized financial institutions  
Such as guarantee company, pawn shop, housing secondary financing, *Permodalan Nasional Madani, LPEI*

# Islamic Financing Provisions for MSMEs: Institutions, Products, and Offerings

## Financing for MSMEs by Islamic Banks



## Financing for MSMEs by Islamic Rural Banks



# The Nature and Type of Support Including Islamic Financial Support Extended by Various Institutions to the MSMEs in Indonesia

Type	Program name	Description	Data Provider
Direct	Productive Support	Cash support IDR 2,4 million per MSME	State-owned Banks, PNM, Cooperatives Bureau
Financial	Investment financing – cooperatives	Revolving Fund Agency (LPDB) distributing funds as a low-interest loan via cooperatives	Cooperatives
Financial	Financing placement	Distributed as low-interest loan by bank	Bank
Financial	Interest subsidy	Subsidy for bank's interest rate	Bank
Financial	Credit assurance for SMEs	Loan insurance for SMEs provided for banks through credit insurance companies to cover potential of SMEs to default	Bank
Financial	Electricity subsidy	100% electricity for MSMEs who subscribes for B1 450 VA and I1 450 VA	

\*The support is channeled through both conventional and Islamic financial institutions

# The Nature and Type of Support Including Islamic Financial Support Extended by Various Institutions to the MSMEs in Indonesia

Type	Program name	Description	Data Provider
Fiscal	Final income tax for SMEs	Subsidy for final income tax for SMEs	SMEs
Trainings		<p>e-learning program EDUKUKM</p> <p>Podcast series to provide guideline in digital business model</p> <p>Webinar series SPARC campus</p> <p>Video series with the theme of New Normal</p>	
Digitalisation		<p>Buddy program for sales in e-commerce</p> <p>Digitalizing MSMEs that are supervised by PLUT-KUMKM</p>	Ministry of Cooperatives and MSMEs

\*The support is channeled through both conventional and Islamic financial institutions



# The Nature and Type of Support Including Islamic Financial Support Extended by Various Institutions to the MSMEs in Indonesia

## **1** POJK No.11/POJK.03/2020

- (i) Financing for less than IDR 10 billion can be based only on the punctuality of principal repayment and/or interest/margin/profit sharing/ujrah until 31<sup>st</sup> of March 2021
- (ii) Debtor who gets restructuring facility can still be classified as good borrower
- (iii) Bank can still provide loan/financing for debtor affected by pandemic

## **2** Restructuring Scheme

- (i) Decrease in interest/principal
- (ii) Decrease for the delayed interest/principal
- (iii) Extend the period
- (iv) Increase the facility line
- (v) Convert the credit into equity participation only for certain period

## **3** Bank's Strategy in the New Normal

- (i) Adopt digital technology in communicating with the clients (phone, online)
- (ii) Provide financing/loan to MSMEs that still have the potential by analysing the business and macroeconomic condition
- (iii) Cooperate with e-commerce/fintech platform to gather MSMEs database
- (iv) Strengthen the credit scoring system and adopt digital lending

# Islamic Social Finance and Financial Support for MSMEs

**248%**

Increase of social fund collected from January to May 2020 (BAZNAS, June 2020)

**70%**

Increase compared to June 2020

Collaboration with the digital platform and e-commerce in the social fund collection  
A new group of *muzakki* (zakat payers) during the pandemic wanted to help others

**30%**

Increase of social funds collected in 2020 compared to 2019

**88.7%**

Has been distributed under various programs in BAZNAS, such as support for medical, non-medical, and economic activities

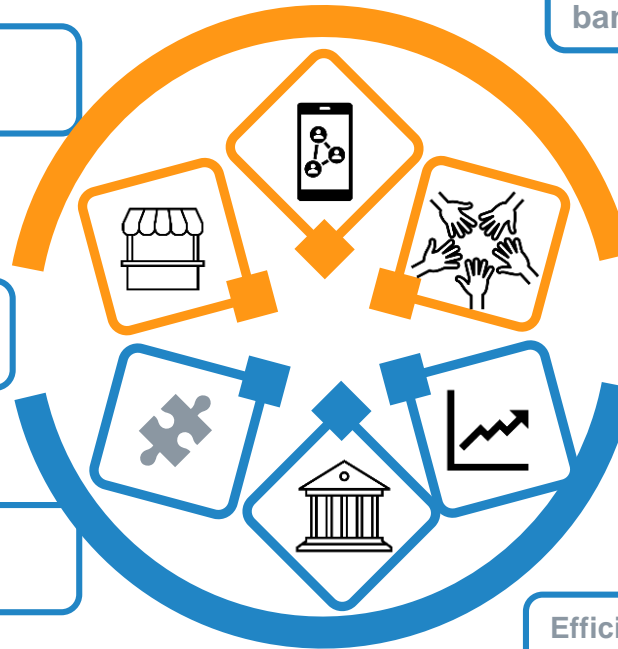
BAZNAS and other *zakah* institutions have provided financial assistance and operational/managerial support for MSMEs under their assistance/training program  
Also taking part in the health emergency project, providing logistic packages, cash for work, cash assistance, and providing cooked food for direct consumption (Hudaefi et al., 2020)

# Best Practices

Relaxation of loan repayment and providing subsidy for loan margin

The Islamic social funds efficiently empowering

The use of technology to support for MSMEs



# Policy Recommendations

The institutional operational logic of Islamic banks should be enabled.

Enabling environment that empowers SMEs

Developing micro-takaful for the MSMEs

Emergency and contingency funds in the form of Shari'ah compliant manner -qard hassan

Efficient international collaboration and cooperation within OIC

Thank you