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Sources of financing Islamic commercial banks rise from benefits, costs, opportunities and risks through Sukuk issuance

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Abstract. The purpose of this study is to pinpoint many elements that support Sharia Commercial Banks (BUS) in expanding their funding sources. Small capital and limited industrial and individual bank scale are among the problems facing sharia banking, according to the 2015–2019 Sharia Banking Roadmap Guidelines. Out of the 13 BUS, only one fell into the BUKU 3 category (capital IDR 5-30 trillion) in terms of capital as of December 2016. Compared to conventional banks, which have 32,730 office units, Islamic banks only have 2,201 office units. This makes it harder for sharia banks to collect deposits from the general population. This suggests that there are funding source issues for Islamic banking as well. Due to a lack of funding, the duty of intermediary cannot be performed as effectively as possible. Sukuk issuing is one way that sharia banking might enhance financial sources. It is vital to take into account the advantages, possibilities, costs, and dangers when issuing sukuk in order to develop a suitable plan for funding increases. The following are contributing aspects to the advantages of issuing sukuk: a source of financing for business expansion; market analysis and sharia benchmarks; many contracts, coupons, and periods; and enhanced liquidity, efficiency, and profitability. Sub-factors for opportunity include: few issuers; high investor demand; robust regulatory backing; and a large investment base. Cost sub-factors include guarantee fees, emission charges, capital expenses, and loan costs. Sub-risk elements include interest rate risk, default risk, sharia compliance risk, and asset loss risk.

Keywords. funding sources, BUS, sukuk, risks

Introduction

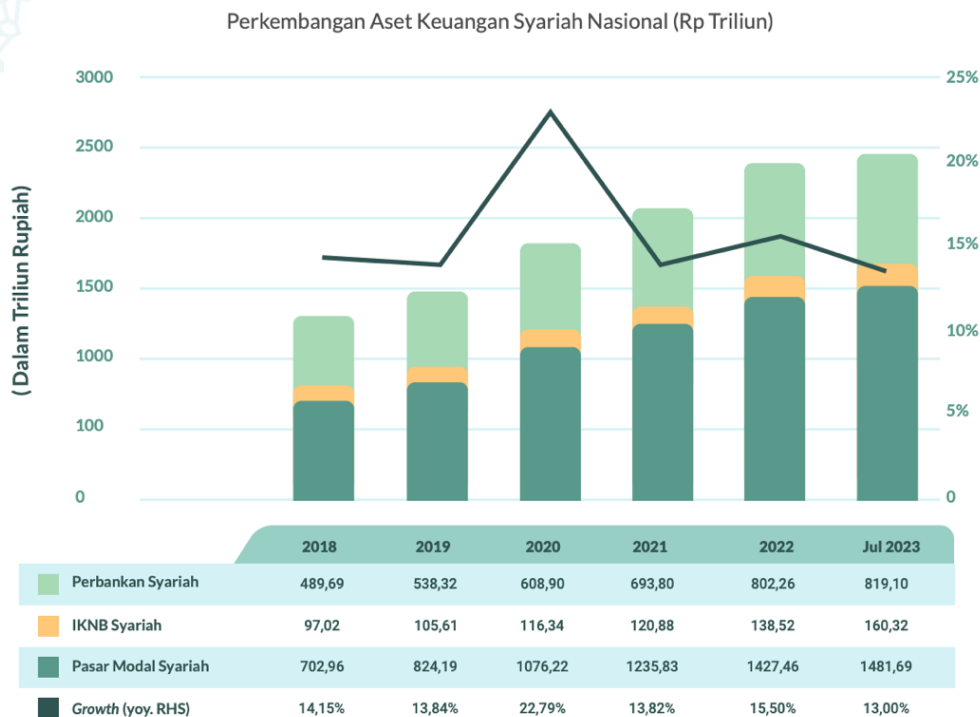
In order to provide financial services in line with sharia principles, sharia commercial banks are crucial. The issue of sukuk is one financing option that is being highlighted in this particular situation. Sukuk have grown to be an important tool for Islamic banks to raise capital since they give them access to funding sources that follow sharia law. The emergence of Sharia Commercial Banks demonstrates a sharp increase in the provision of goods and services compliant with Islamic law. These banks are being prompted to investigate different financing options that adhere to sharia principles by the growing market demand for sustainable and halal financial goods. Islamic banks obtain their funding from a variety of sources, including sukuk.

Unlike traditional financial products, sukuk, or sharia bonds, provide a source of funding based on asset and profit sharing principles.

Due to the substantial expansion of the sharia financial services sector in Indonesia, it is anticipated that this nation would rank among those that will eventually dominate the worldwide sharia financial market. In the State of the Global Islamic Economy Report 2014-2015, published by Reuters and Standard (2014), Indonesia is ranked 10th globally for the development of the sharia finance sector. In terms of investment, Indonesia was ranked third in the 2015 Markets Investment Report by UNCTAD, behind only the United Arab Emirates and Malaysia. However, Indonesia's population and GDP growth rates are higher than those of Malaysia and the UAE, giving it a greater potential for growth.

The most advanced sector of the whole sharia financial sector is sharia banking. With a banking network made up of 166 Sharia People's Financing Banks (BPRS), 21 Sharia Business Units (UUS), and 13 Sharia Commercial Banks (BUS), the total sharia banking assets in Indonesia as of the end of December 2016 were IDR 373.92 trillion. In comparison to the whole banking sector, which only had 13.87% growth in assets between 2012 and 2016, sharia banking assets have the potential to increase by an average of 18.35%. Similarly, with an average FDR of 95.98%, the intermediation function of sharia banking is empirically superior to that of total banking. Because sharia banking can function as investment or commercial banking, which can propel the actual and productive economic sector, intermediation plays a crucial role. In the 2015-2019 Sharia Banking Roadmap Guidelines, the Financial Services Authority (2015) outlines the various obstacles that sharia banking is facing, such as the relatively small capital of sharia banks, low efficiency, and the industry's and individual banks' limited scale. Syafrida and Indianik (2016), who looked into the halt in the expansion of Islamic banks, also expressed this. Out of the thirteen BUS that were in operation as of the end of December 2016, only Bank Syariah Mandiri was classified as a BUKU 3 entity (with core capital ranging from Rp 5 to Rp 30 trillion). Five BUS fall into the BUKU 1 category (core capital Rp. 100 billion–Rp. 1 trillion), while the remaining six BUS fall into the BUKU 2 category (core capital Rp. 1–Rp. 5 trillion). According to a Bank Indonesia report, banking companies need to raise their core capital to more than Rp 5 trillion or fall into the BUKU 3 category in order to attain the best economies of scale.

In order to raise money from the general public, sharia banking must also overcome obstacles in the form of creating sharia financial assets. As a result, the industry's size has not yet realized its full potential. As demonstrated in Table 1, there are fewer service office networks (2,201 offices) than conventional banks (32,730 offices), indicating this. Sharia banks must find funding sources with qualities that fit these requirements since they require substantial sums of money with long-term returns to meet these needs.



Many of these issues suggest that Islamic banking has difficulties finding sources of finance. Issuing securities in the form of sukuk and public shares is one of the ways that sharia banking can expand its funding sources. The sources of funding that banks rely on to perform their financial intermediation function are crucial to their operations. Intermediation in financing has a role that can support economic expansion. The bank's actual contribution, nevertheless, truly hinges on its ability to carefully balance its resources—both available funding sources and assets and liabilities—as noted by Alu et al. (2015). Looking at the BUS firms that issued sukuk through the end of December 2016, four of the 13 new BUS—Bank Muamalat Indonesia (BMI), Bank Syariah Mandiri (BSM), Bank Negara Indonesia Syariah (BNIS), and Bank Rakyat Indonesia Syariah (BRIS)—became issuers. Banks can alter and improve their capital structure by issuing sukuk. It can also have an impact on how efficiently operating costs and profit-sharing income are handled, as well as increase the amount of financing provided by mudharabah and musyarakah. Moreover, it can serve as an alternative form of funding and a preventive measure against deposit withdrawals or the failure of financing projects. Finally, it can increase the amount of financing disbursed and improve financial ratios such as ROE, FDR, and NIM (Awaludin 2016).

The results of a number of earlier research on the issuance of sukuk, such as Septiana (2010), indicate that the impact of issuing subordinated bonds can raise capital as well as interest income and long-term demand. According to Said (2011), Islamic banking was impacted in 2008 by the global financial crisis in terms of its strength, distribution, efficiency, and profitability. Islamic banking uses sukuk instruments to support corporate firms by offering liquidity and resource mobility in order to overcome this. According to Akbarullah (2011), the sukuk issue increased the quantity of money distributed, resulting in higher ROE, FDR, and NIM financial ratios. According to Sapulete and Manurung (2014), commercial banks can considerably raise ROA and ROE by issuing subordinated bonds.

Theoretical basis

a. Basic Concept of Sukuk as a Source of Financing

Sukuk, as a sharia financial instrument, offers a unique source of financing for Sharia Commercial Banks. It is based on the concept of asset ownership and profit sharing, which is in accordance with sharia principles.

b. Benefits of Sukuk Issuance for Sharia Commercial Banks

Issuing sukuk provides a number of benefits for Islamic banks, including wider access to global financial markets, diversification of financing sources, and increased trust and reputation as a financial institution committed to sharia principles.

c. Opportunities Faced by Sharia Commercial Banks through Sukuk Issuance

The issuance of sukuk opens up new opportunities for Islamic banks in terms of diversifying funding sources, increasing liquidity, and expanding the investor base that can provide financial support.

d. Risks Associated with the Issuance of Sukuk

Apart from the benefits, sukuk issuance also presents risks for Islamic banks, including liquidity risk, market risk and structural risk which need to be managed carefully.

e. Influence Factors

In the context of sukuk issuance, there are key factors that influence sharia bank decisions, ranging from global financial market conditions, regulatory policies, to capital requirements and the bank's risk profile.

Through an in-depth understanding of this theoretical foundation, it is hoped that this research can provide comprehensive insight into sources of financing for Sharia Commercial Banks through sukuk issuance, clarify the benefits, costs, opportunities and risks involved, as well as identify important factors that influence the decision to issue sukuk by sharia banks.

Research methods

The areas of Bandung and Jabodetabek were the focus of this study. Purposive sampling of the areas where the respondents could be located was used to determine the location. From May to December 2017, a total of eight months were dedicated to the research. In order to get answers to research questions, researchers performed in-depth interviews with respondents as part of this mixed-methods qualitative and quantitative study project. The literature that is directly relevant to the research problem was also reviewed by the researchers. Primary and secondary data were employed in this study. Five four BUS practitioners (at the level of head of treasury division) and sukuk issuers from Bank Muamalat Indonesia, Bank Syariah Mandiri, Bank Negara Indonesia Syariah, and Bank Rakyat Indonesia Syariah provided the primary data through in-depth interviews. Bank Panin Syariah, Bank Negaran Syariah Pension Savings, Bank Jabar Banten Syariah, and Maybank Syariah are the four BUS practitioners that have not issued sukuk.

Four regulatory practitioners from Bank Indonesia, the Financial Services Authority, the State Sharia Council-Indonesian Ulema Council, and the Indonesian Stock Exchange were also interviewed regarding sukuk.

Book literature, journals, theses, dissertations, working papers, and other published reports that are directly relevant to the issue of sharia bank funding sources were the sources of secondary data. Purposive and convenience sampling were used in this study's respondent selection process. The non-probability sampling technique includes this sampling (Sekaran, 2003). Experts with expertise and experience who can respond to study questions in order to provide theoretical insight are the respondents who were chosen (Saunders et al. 2009).

Results and discussion

Based on the results of interviews with practitioners of sukuk issuing BUS, non-sukuk issuing BUS, and regulators, information was obtained on several factors for sukuk issuance based on benefits, opportunities, costs and risks. The classification of these factors is:

a). Benefit Factor

In the benefit factor, there are 4 sub-factors that are taken into consideration or influence, namely i). source of funds for business expansion and capital, ii). market profiling and sharia benchmarks, iii). multi contracts, coupons and periods, iv) increasing liquidity, efficiency and profitability.

According to Alsaeed (2012), the corporation produces sukuk to diversify its funding sources and has the ability to alter and enhance banks' capital structures (Awaludin, 2016). A sharia benchmark is the issuing of sukuk, which diversifies funding sources and meets finance demands (Pramono and Setiawan, 2006). The issuing of sukuk is associated with various concerns, such as the requirement for a secondary market, benchmark-based returns, and standardization of sukuk scheme contracts (Abdo, 2014). According to Zein et al. (2011), there are various ways to structure sukuk. Sukuk indicate partial ownership in a debt (Murabahah sukuk), asset (al-Ijarah sukuk), project (al-Istishna sukuk), business (al-Musyarakah sukuk), or investment (al-Istithmar sukuk), in contrast to traditional bonds, which are a promise to repay a loan. These various sukuk structures are the outcome of context-based *ijtihad* produced by Islamic scholars and philosophers rather than being found in the Qur'an and Sunnah (Saeed and Salah, 2013). According to Amir (2007), sharia bonds (sukuk) are issued with a variety of contracts, such as the *ijarah* contract to obtain a fixed yield, the *mudharabah/musyarakah* contracts with floating yield rates, or the *istishna* contracts, which are equivalent to zero coupon bonds. Conventional bonds are issued by promising yields with fixed, floating, or discounted coupons (zero coupon bonds). According to Sallama (2005), sukuk can affect how effectively operating expenses and profit-sharing revenue are managed in addition to raising the amount of finance for *mudharabah* and *musyarakah*. Akbarullah (2011) discovered that, in the meantime, the sukuk issue had an effect on raising the quantity of finance disbursed, raising financial ratios in ROE, FDR, and NIM, and lowering CAR.

b). Opportunity Factor

Four criteria are considered or influenced by the opportunity factor: i) small number of issuers; ii) high investor demand (oversubscribed); iii) strong regulatory support; and iv) broad investor base. According to Pramono and Setiawan (2006), there are two chances for issuing sukuk: as an alternative funding source for infrastructure, and as excess liquidity in investor money from Middle Eastern countries, which total USD 800 billion. According to Wicaksana and Permatasari (2013), there is a chance to issue sukuk because of the market's high reactivity

to such issuances, Middle Eastern investors' substantial demand for sharia bonds, and the need for funding for large-scale mining projects. According to Armadiyanti (2013), there are several benefits to issuing sukuk, including its ability for secure liquidity distribution, Indonesia's sizable Muslim population, its potential for economic growth, and its use as a substitute reserve for the APBN deficit and monetary policy.

c). Cost Factor

The cost factor is composed of four sub-factors: capital expenses, debt costs, underwriting fees, and emission fees. These sub-factors are all taken into account or have an influence.

According to Jiwandaru and Taufiqurrahman (2010), the issuing of sukuk generally entails a number of fees, such as:

a. Cost of Capital

Is a crucial consideration when choosing whether to use stock or borrowed financing. Capital costs are expenses that have to be incurred or paid for. to raise sufficient funds for business investments through debt, preferred shares, common shares, and retained earnings. Cost of capital is a concept that applies only to long-term choices.

b. Debt Service Cost

Interest is not included in the capital costs calculation for sukuk. The amount of profit that sukuk investors seek is calculated differently depending on the terms of the contract. The issuer of an ijarah sukuk gives the investor a set rental fee. In contrast, the issuer of mudharabah sukuk distributes profit sharing to investors based on the amount of profit realized.

c. Floating Expenses

Two kinds of floating expenses are available to businesses looking for long-term funding. The underwriter's spread comes first. The second category of expenses is publication, which also includes guardianship, accounting, legal, and printing and engraving fees, among other things. According to Diaw et al. (2013), partnership-based sukuk are the best kind of sukuk for profitable business ventures because they are also advantageous in terms of structural simplicity and capital cost effectiveness.

d. Variables at Risk

There are four sub-elements that make up risk factors that are either influenced or taken into account: default risk, sharia compliance risk, interest rate risk, and danger of losing underlying assets.

The following are the risks associated with conventional bonds, per Nanaeva (2010):

a. Interest rate risk: bond yields, as an income vehicle, move in opposition to changes in interest rates. Bond prices will decline when interest rates rise. However, there is a greater chance that interest rates will increase the longer the bond's maturity. The degree of interest rate risk will rise as a result.

b. Default risk: The bond issuer runs the risk of being unable to pay the principal amount of the bond as well as the periodical installments (coupons).

According to Wahid (2010), originators and issuers face the following types of loss risk that are often associated with assets:

- a. Possession of asset risk
loss of assets as a result of fire or natural disasters and a decline in asset value
- b. Not making a new purchase

The originator will not be able to repurchase the assets within the contractually stipulated time frame if he files for bankruptcy.

Article I. The primary activity (core business) must be halal and must not contradict the key points of Fatwa No. 20/DSN-MUI/IV/2001 in order for the sukuk to be issued. The fatwa describes a range of commercial practices that are forbidden due to their incompatibility with sharia law (Sudarsono, 2008). According to Tariq and Dar (2007), issuers of sukuk must get the Sharia Supervisory Board's endorsement in order to comply with sharia law respecting the sukuk structure. Elshazly and Tripathy (2013) noted that the primary obstacle facing the sukuk market is the requirement that the underlying assets that produce revenue streams adhere to sharia law.

Conclusion

In order for sharia banks to develop an effective financing expansion plan, it is imperative that the benefits, opportunities, costs, and risks associated with issuing sukuk be taken into account. The following are some of the sub-factors that contribute to the advantages of issuing sukuk as a substitute for funding from second parties: a source of money for business expansion; market analysis and sharia benchmarks; multiple contracts, coupons, and periods; and improved liquidity, effectiveness, and profitability. The following are sub-factors of opportunity: few issuers, high investor demand, robust regulatory backing, and a wide range of investors. Capital expenses, loan costs, guarantee fees, and emission costs are some examples of cost sub-factors. The following are sub-risk factors: interest rate risk, default risk, sharia compliance risk, and asset loss risk.

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