

MITIGATION STRATEGY OF ISLAMIC FINANCING RISK: A CASE OF BANK JATIM SYARIAH

Syaifuddin^{1*}

Abu Sanmas²

Asep Hedi Turmudi³

^{1,2,3}Institut Agama Islam Negeri Ternate, Indonesia

*¹Corresponding Email: ifudsby@iain-ternate.ac.id

ABSTRACT - This study examines the financing risk management practices of Bank Jatim Syariah, a prominent provincial-owned Islamic bank in Indonesia with total assets of IDR400 trillion, in response to the rising trend of Non-Performing Financing (NPF) in Islamic banking over the past decade. The research focuses on Bank Jatim Syariah due to its extensive service area, large customer base, and substantial financing portfolio. Employing a qualitative methodology, data was collected through interviews with the bank's financing committee and management, coupled with an analysis of pre-pandemic financing documents. The findings reveal that Bank Jatim Syariah has successfully implemented a robust NPF mitigation mechanism, including debt restructuring, debt scheduling, and both litigious and non-litigious dispute resolution strategies. These measures have effectively reduced NPF levels below 2.35%, minimized bank losses, and ensured the bank's continued ability to serve its 40 million customers in East Java. The study highlights the importance of proactive risk management strategies in maintaining the stability and growth of Islamic banking institutions.

Keywords: Islamic Banking, Risk Management, Non-Performing Financing (NPF), Mitigation Strategies, Financial Stability

ABSTRAK – Strategi Mitigasi Risiko Pembiayaan pada Bank Jatim Syariah. Penelitian ini mengkaji praktik manajemen risiko pembiayaan Bank Jatim Syariah, salah satu bank syariah terbesar milik pemerintah daerah di Indonesia dengan total aset Rp. 400 triliun. Hal ini sebagai respons terhadap tren peningkatan Non-Performing Financing (NPF) di perbankan syariah selama satu dekade terakhir. Penelitian ini difokuskan pada Bank Jatim Syariah karena wilayah layanannya yang luas, basis nasabah yang besar, dan portofolio pembiayaan yang substansial. Dengan menggunakan metode kualitatif, data dikumpulkan melalui wawancara dengan komite pembiayaan dan manajemen bank, serta analisis dokumen pembiayaan pra-pandemi. Temuan penelitian mengungkapkan bahwa Bank Jatim Syariah telah berhasil menerapkan mekanisme mitigasi NPF yang kuat, meliputi restrukturisasi utang, penjadwalan ulang utang, serta strategi penyelesaian sengketa, baik secara litigasi maupun non-litigasi. Langkah-langkah ini secara efektif telah mengurangi tingkat NPF di bawah 2,35%, meminimalkan kerugian bank, dan memastikan kemampuan bank untuk terus melayani 40 juta nasabahnya di Jawa Timur. Studi ini menekankan pentingnya strategi manajemen risiko proaktif dalam menjaga stabilitas dan pertumbuhan lembaga perbankan syariah.

Kata Kunci: Perbankan Syariah, Manajemen Risiko, Non-Performing Financing (NPF), Strategi Mitigasi, Stabilitas Keuangan

INTRODUCTION

The rapid growth of Islamic banks in Indonesia has been remarkable, with their market share increasing from 0% in 1991 to 5% in 2020. As of the first quarter of 2020, the total assets of Islamic banks reached 616 trillion rupiah, compared to 12,030 trillion rupiah for conventional banks. The Islamic banking sector in Indonesia comprises 15 Islamic commercial banks, 19 Islamic business units (UUS) of conventional banks, and 163 Sharia People's Financing Banks (BPRS), with a combined network of 843 branch offices, 1,519 sub-branches, and 570 cash offices. Productive financing by Islamic banks in Indonesia reached 572 trillion rupiah as of July 2021 (OJK, 2021).

Despite the growth of Islamic banking, financing risk remains a concern, as reflected in the Non-Performing Finance (NPF) ratio of 2.3%, which is lower than the national average of 4.2% for Non-Performing Loans (NPL) in conventional banks. The establishment of Bank Jatim Syari'ah by the East Java Provincial government aims to capitalize on the immense potential of the Islamic economic sector in the region, which has a population of 40 million and 220 Islamic bank branches serving 6 million customers (Bank Jatim, 2020).

Risk management has been a primary focus for Islamic banks since their inception. Financing risk can stem from various factors, including the bank's financial ratios, asset management, and economic crises. Effective asset management strategies have proven crucial in safeguarding Islamic banks from the shocks of financial and economic crises. Additionally, the relationship between capital adequacy and financing risk management is a critical concern for bank supervisory authorities, as mandated by the Basel Accords (Abusharba et al., 2013; Othman et al., 2017). This study aims to investigate the characteristics of financing risk management at Bank Jatim Syari'ah, one of the state-owned Islamic banks in Indonesia, and to identify the strategies employed to mitigate Non-Performing Financing (NPF) and ensure the bank's stability and growth in the face of increasing competition from both Islamic and conventional banks.

This study fills several research gaps and enriches the existing literature on Islamic banking and risk management. Unlike previous studies that have generally examined risk management practices in Islamic banks, this study specifically focuses on Bank Jatim Syariah, a state-owned Islamic bank with a large customer base and substantial financing portfolio. The study delves into



the analysis of financing documents from the pre-pandemic period, offering insights into the bank's risk management practices before the COVID-19 crisis. This analysis aids in understanding how Islamic banks managed financing risks during a relatively stable period.

Furthermore, the study identifies specific strategies that Bank Jatim Syariah employed to mitigate Non-Performing Financing (NPF). These strategies include debt restructuring, debt scheduling, and dispute resolution, details often overlooked in existing studies on Islamic bank risk management. The study also explores the critical relationship between capital adequacy and financing risk management, a concern for bank supervisory authorities. By examining this relationship in the context of Bank Jatim Syariah, the study enhances our understanding of how capital adequacy impacts financing risk in Islamic banks. The novelty of this study lies in its unique focus on a specific state-owned Islamic bank, its analysis of pre-pandemic financing documents, and the identification of specific NPF mitigation strategies. These aspects offer fresh insights into the financing risk management practices of Islamic banks operating in a unique context.

The significance of this study is twofold. Firstly, it adds to the growing body of literature on Islamic banking and risk management, providing valuable insights for researchers, policymakers, and practitioners. Secondly, the study's findings can guide the development of effective risk management strategies for Islamic banks, especially those operating in similar contexts, ensuring their stability and growth amidst increasing competition and economic challenges.

LITERATURE REVIEW

This literature review delves into the complexities of financing risk management within Islamic banks. It explores various factors influencing risk and highlights potential strategies for mitigating NPL (Non-Performing Financing) growth. The review integrates research findings from a diverse range of sources to provide a comprehensive understanding of this critical aspect of Islamic banking.

Customer Behavior and Risk Management in Islamic Banking

The risk management strategies employed by Islamic banks are demonstrably influenced by the characteristics of their customer base. Unlike conventional banks, Islamic banks cater to a clientele whose financial decisions are shaped



by a confluence of religious and socio-economic factors (Syaifuddin, 2018). This regional variation, particularly evident in the diverse ethnic and cultural landscape of East Java, necessitates a nuanced approach to risk management for Bank Jatim Syariah (Syaifuddin, 2018).

Furthermore, the inherent risk profiles of Islamic financing instruments play a significant role. Research conducted by the Islamic Development Bank highlights that Murabahah and Ijarah contracts pose a lower risk compared to other financing models (IBI, 2018). This finding is particularly relevant for Bank Jatim Syariah, considering Murabahah is the most popular financing option chosen by its customers (IBI, 2018).

The literature also suggests a potential advantage for Islamic banks in terms of Non-Performing Financing (NPF) levels. Studies comparing Islamic and conventional banks operating in dual banking systems indicate generally lower NPF rates for Islamic institutions (Yazdan & Hossein, 2012; Elkamiliati, & Ibrahim, 2014). This observation underscores a potential link between Islamic financing models and economic growth. Research by Gudarsi Farhani (2010) suggests a reciprocal relationship, where Islamic bank financing can influence a nation's economic growth, and vice versa (Yazdan & Hossein, 2012; Hasanah, & Ibrahim, 2013).

Finally, the concept of depositor behavior presents an interesting parallel between Islamic and conventional banks. Studies suggest that depositors may switch between both banking systems based on the relative attractiveness of profit-sharing rates offered (Kasri & Kassim, 2009; Othman et al., 2017; Shaban et al., 2014). This necessitates a dynamic financing plan for Bank Jatim Syariah, especially considering its dependence on customer deposits (IBI, 2018).

Interest Rates, Depositor Behavior, and NPF in Islamic Banking

Despite their non-reliance on interest-based financing, Islamic banks still experience a degree of influence from interest rate fluctuations set by central banks. A study encompassing all Malaysian Islamic banks over a period of 1997-2008 suggests a correlation between interest rates and financial risk management in these institutions (Zainol & Kassim, 2010; Ibrahim, & Fitria, 2012). The potential mechanism for this influence is not explicitly addressed in the cited research, but it warrants further investigation.



Depositor behavior also presents a crucial factor in Islamic bank risk management. Depositors exhibit a tendency to move their funds between Islamic and conventional banks based on the relative attractiveness of profit-sharing rates offered (Kasri & Kassim, 2009; Othman et al., 2017; Shaban et al., 2014). This necessitates a dynamic approach to financing plans at Bank Jatim Syariah, particularly given its heavy reliance on customer deposits (IBI, 2018). Banks must carefully consider deposit behavior to ensure a stable funding base for financing activities.

The literature also suggests that Non-Performing Financing (NPF) in Islamic banks may not be directly impacted by corporate governance inefficiencies. Research by Havidz and Setiawan (2015) analyzing data from Bank Indonesia during the 2008-2014 global economic crisis found no significant correlation between corporate governance and NPF levels in Islamic banks. This finding, while limited to a specific timeframe and geographical context, offers an interesting counterpoint to the prevailing focus on corporate governance as a risk mitigation strategy. Further research is needed to explore the generalizability of this observation across diverse economic conditions and banking systems.

Liquidity Management, Macroeconomic Conditions, and Performance Measurement in Islamic Banking

The financial management strategies employed by Islamic banks directly impact their overall financial performance. Liquidity management, in particular, plays a crucial role in mitigating financing risk (Rahman & Banna, 2016). Three key factors influence liquidity risk management in Islamic banks: net capital, asset size, and profitability (Return On Assets or ROA). These factors essentially reflect the bank's ability to efficiently utilize its assets and generate profits (Rahman & Banna, 2016).

Beyond internal factors, Islamic banks also need to consider the influence of external macroeconomic conditions. Variations in economic performance across different districts within East Java, for instance, can significantly impact the profitability of Islamic banks operating in those regions (Masood et al., 2015). Consequently, effective risk management strategies for Islamic bank financing must take these macroeconomic factors into account.

Performance measurement in Islamic banking is often facilitated by Sharia-compliant tools. One such instrument is the Maqashid Sharia Index, designed



to assess the adherence of Islamic banks to Islamic principles. Studies comparing Islamic banks in Indonesia and Jordan using this index suggest that Indonesian Islamic banks exhibit a higher level of compliance with Sharia principles (Syafii et al., 2012). This finding offers valuable insights for Bank Jatim Syariah in its pursuit of continuous improvement in Sharia-compliant operations.

Competition, Risk Profiles, and Credit Growth in Islamic Banking

The prevailing public perception suggests that a growing number of Islamic banks in Indonesia would intensify competition within the sector, potentially destabilizing the Islamic financial system. However, research by Rizvi et al. (2020) challenges this notion. Their findings indicate that competition among Islamic banks actually contributes to the stability of the Islamic banking industry, even though it may not necessarily lead to increased profitability.

Islamic banks face a unique challenge when it comes to financing small businesses. While this sector offers potentially higher returns, it also carries a greater risk of default. Conventional and large banks often shy away from financing small businesses due to these risks. Islamic banks, however, are more willing to step in and provide financing, despite the potential for reputational damage if defaults occur (Shaban et al., 2014). Striking a balance between supporting small businesses and managing risk exposure remains a critical challenge for Islamic banks.

A key advantage of Islamic financing instruments based on buying-selling and renting principles is their relative independence from conventional bank interest rates. Šeho et al. (2020)—analyzing 77 Islamic banks across 13 countries between 2003 and 2017—supports this notion. Unlike conventional banks that rely on interest rates as a credit reference point, Islamic financing based on these principles operates on a profit and risk-sharing system, decoupling risk profiles from conventional interest rate fluctuations.

The literature also highlights the correlation between credit growth and risk management in Islamic banking. Studies by Sobarsyah et al. (2020) suggest that rapid credit expansion can lead to heightened credit risk in the subsequent year, particularly for Islamic banks with larger capital bases. Mudarabah contracts appear to be the second most prevalent option after buy-and-sell (Murabahah) contracts. Importantly, Warninda et al. (2019) highlight a lower risk profile associated with Mudarabah compared to Musharakah financing. This finding



validates the current financing strategy of Indonesian Islamic banks, which prioritizes Mudarabah due to the significantly higher risk associated with Musharakah contracts, particularly when exceeding 35% of the total financing portfolio. This underscores the importance of implementing prudent risk management strategies, especially in light of potential economic crises like the COVID-19 pandemic. The ever-present threat of financial crises necessitates constant vigilance and proactive risk management practices by Islamic banks.

Microfinance, and State Ownership in Islamic Banking

Islamic microfinance institutions (IMFIs) present a significant concern for regional development banks and government-owned Islamic banks. Research by Fianto et al. (2019) underscores the inherent riskiness of financing within IMFIs. Their analysis of 14 Islamic financial institutions revealed a mixed performance, with 5 exhibiting poor financing returns and only 9 demonstrating strong performance. These findings suggest a need for caution from Indonesian Islamic banks when considering financing activities with IMFIs.

State-Owned Islamic Banks (SOIBs), managed by local governments or state-owned enterprises, operate within a framework of political influences. While these banks may enjoy certain advantages over private Islamic banks, political decision-making introduces additional risk. Belkhir et al. (2019) conducted a study encompassing a broad sample of banks (1,245) from various countries. Their findings suggest that conventional banks are generally more vulnerable to financial crises compared to Islamic banks. This potentially offers SOIBs a competitive edge.

The literature also suggests potential profitability advantages for SOIBs. Research by Duqi et al. (2020) indicates that SOIBs, particularly those owned by governments, tend to offer higher dividend payouts compared to conventional banks. This enhanced profitability translates into greater development opportunities for SOIBs compared to their conventional counterparts. Furthermore, higher profitability allows SOIBs to attract a wider range of investors, enabling them to be more selective in their financing activities. This selectivity can, in turn, contribute to a more risk-averse financing approach.



Competition, Liquidity, and Political Systems in Islamic Banking

The competitive landscape within the Islamic banking sector can significantly influence risk management strategies. Studies by Meslier et al. (2017) suggest that competition among Islamic banks might be more intense compared to competition with conventional banks in a dual banking system like Indonesia. This is attributed to the potentially higher interest rates offered by conventional banks, particularly large institutions with strong capital bases. These lower interest rates can diminish the relative attractiveness of Islamic banking products, thereby impacting financing strategies and associated risk profiles within Islamic banks.

For Islamic banks operating in developing countries, liquidity management emerges as a crucial factor for achieving a competitive edge. Research by Bitar et al. (2018) highlights a range of potential risks faced by Islamic banks in these contexts, including political instability, corruption, limited access to capital markets, and weak legal enforcement. These factors necessitate a heightened focus on liquidity management as a primary consideration for risk mitigation in such environments.

The political system of a nation can exert a significant influence on the health of both Islamic and conventional banks. Bitar et al. (2017) propose a potential link between democratic systems and a stronger state role in ensuring bank health. However, the study acknowledges limitations in its explanation of this relationship, particularly the lack of a clear definition of "democratic measures" and their impact on the varying levels of competitiveness observed between Islamic and conventional banks. This underscores the need for further research to explore the nuances of political systems and their influence on the competitive dynamics within the banking sector. Furthermore, the study emphasizes the importance for Islamic banks to develop differentiated strategies tailored to the specific political realities of their operating environment.

Economic Crises, Financial Ratios, and Innovation in Islamic Banking

Several studies have established a strong correlation between economic crises and heightened financing risk for Islamic banks (Olson & Zoubi, 2017). These studies also point to variations in the recovery capacities of different Islamic banks following economic downturns. The research often employs quantitative methods to assess the impact of crises on various financial ratios within Islamic



banking. Ultimately, these changes in financial ratios influence the overall risk management strategies adopted by Islamic banks.

The increasing use of hybrid contracts in Islamic banking raises unique risk considerations compared to the traditional contract systems employed in the early days of Islamic banking in Indonesia (Puspitasari, 2015). These derivative contracts, driven by practical needs, allow Islamic banks to offer more innovative financial products. However, this innovation comes at the cost of introducing new risks. Similar observations have been made in the field of Islamic insurance, which shares certain characteristics with Islamic banking. Notably, one key risk associated with hybrid contracts is the potential loss of flexibility for banks in allocating financing resources from funds under their management.

Research by Smaoui et al. (2020) highlights the importance of maintaining an appropriate capital adequacy ratio relative to third-party funds in Islamic banks, particularly in the short term. This ratio, along with bank size, deposit structure, and overall competitiveness, can significantly impact the risk management strategies of Islamic banks.

Studies comparing the portfolio performance of Islamic banks and conventional banks during financial crises suggest a potential advantage for Islamic institutions (Sorwar et al., 2016). These studies often employ various risk management assessment methodologies. The findings suggest that Islamic banks may exhibit superior risk management capabilities compared to their conventional counterparts during periods of economic crisis. Interestingly, similar observations have been made beyond the banking sector. Research indicates that Islamic stock portfolios may outperform conventional stock portfolios during crises. This evidence suggests that incorporating Islamic bank shares into a broader investment portfolio could be a viable strategy for mitigating risk exposure in the stock market.

METHODOLOGY

Design

This study employs a comprehensive research methodology to gain an in-depth understanding of financing management at Bank Jatim Syariah. The methodology is designed to examine and analyze the activities of planning, organizing, implementing, and monitoring financing activities, as well as to



investigate how Bank Jatim Syariah mitigates financing risk from Non-Performing Financing (NPF).

Data Collection

The main data for this study consists of both verbal and non-verbal information. Verbal data is collected through semi-structured interviews, conversations, and question-and-answer sessions with key stakeholders at Bank Jatim Syari'ah, including managers, employees, and customers. These interactions are recorded and transcribed for analysis. Non-verbal data, in the form of publications and banking report documents, is also gathered to support the verbal data (Syaifuddin, 2019). Purposive sampling is employed to select participants for the interviews and conversations. This technique ensures that the selected individuals have relevant knowledge and experience in financing management at Bank Jatim Syari'ah, thereby providing rich and informative data for the study.

Data Analysis

A thematic analysis approach will be employed to extract meaning from the collected data. This rigorous process involves a series of steps. First, the researcher will embark on a thorough familiarization with the data, meticulously reviewing transcripts and documents to gain a comprehensive understanding of the content. Subsequently, the data will undergo a systematic coding process, which entails identifying and labeling relevant segments of text that capture key concepts and ideas. Following this, the analysis progresses to generating themes. Through meticulous examination of the coded data, broader themes and patterns that emerge across the dataset will be identified. To ensure the accuracy and relevance of the identified themes, a review and refinement stage will follow. Finally, the themes will be clearly defined and named, capturing their essence and connection to the study's objectives. The culmination of this analysis will be a comprehensive report that presents the findings in a clear and concise manner, substantiated by relevant quotes and illustrative examples gleaned from the data.

Validity and Reliability

To bolster the robustness and credibility of this investigation, a multifaceted approach will be employed to ensure both the validity and reliability of the data. Triangulation, achieved through the utilization of diverse data sources, both



verbal and non-verbal, and a confluence of data collection methods, including interviews, open-ended conversations, and document analysis, will facilitate the cross-validation of the research findings. Furthermore, member checking will be implemented, which entails sharing the emergent themes and interpretations with participants to confirm the accuracy of these constructs and to glean any supplementary insights. To mitigate the influence of potential researcher bias and to identify inconsistencies, peer debriefing sessions will be conducted with colleagues and established authorities within the field. Finally, a meticulous audit trail will be meticulously documented, encompassing all stages of the research process, from data collection and analysis to the final interpretation. This comprehensive record will ensure transparency and allow for the potential replication of the study's methodology and subsequent findings.

RESULT AND DISCUSSION

Growth and Products

Bank Jatim, established on August 17, 1961, began its operations in accordance with the Decree of the Minister of Finance of the Republic of Indonesia No. BUM 9-4-5 on August 15, 1961. The bank's primary tasks include participating in encouraging the growth of regional economic potential through the development of the small and medium business sector and collecting funds, distributing funds, and providing other banking services (Bank Jatim, 2020). On August 21, 2007, Bank Jatim started offering sharia banking services through its Sharia Business Unit (UUS).

Sharia banking in East Java has very wide prospects and opportunities, providing Bank Jatim with a good opportunity to serve customers and the community through its UUS. Bank Jatim has 7 sharia branch offices, 8 sub-branches, and 7 sharia payment points across various cities in East Java. Additionally, the UUS has a sharia service office (KLS) located in 39 branch offices and 152 conventional sub-branches (Syarifuddin, 2021).

Bank Jatim UUS offers various sharia-compliant fund collection products, including Amanah Current Account, Hajj Amanah Savings, Barokah Savings, Tabunganku, Barokah Deposits, and Simple iB Savings (Bank Jatim, 2020). These products are designed to cater to different customer needs, from regular savings to specialized accounts for hajj pilgrimage financing.



1. Amanah Current Account: This product uses the *Wadiah Yad Adh Dhamanah* principle, allowing customers to withdraw funds anytime using a check or bilyet giro.
2. Hajj Amanah Savings: Savings intended for financing hajj pilgrimage.
3. Barokah Savings: Savings based on the *Mudharabah* (Profit Sharing) principle, with withdrawals possible through ATM Prima and ATM Bersama across Indonesia.
4. TabunganKu: A savings account with the *Wadiah Yad Adh Dhamanah* principle, aimed at promoting the culture of saving.
5. Barokah Deposits: Time deposits based on the *Mudharabah mutlaqoh* principle with an agreed profit-sharing ratio.
6. Simple iB Savings: A savings account for students under 17 years old, promoting early financial education.

In addition to these, Bank Jatim Syariah offers several financing products, such as:

1. Kafalah: Bank guarantees for offer guarantees, performance guarantees, and maintenance guarantees.
2. Gold Metal Ownership (KLE) iB Barokah: Financing for customers to buy gold bars with monthly installments.
3. Multipurpose Syari'ah: Financing for fixed-income customers based on the Murabaha principle.
4. Umrah iB Maqbula: Umrah travel financing with fixed installments.
5. Financing to Cooperatives and Cooperatives to Members (PKOP/PKPA): Working capital or investment financing for cooperatives.
6. Syndicated Financing: Working capital or investment financing requiring a lead manager.
7. BPRS Linkage Financing: Financing for BPRS, distributed to BPRS customers, micro, and small customers.
8. Presidential Decree Financing: Working capital financing for contractors, with repayment from project terms.

Bank Jatim Syariah has demonstrated an increased ability to raise third-party funds, including Amanah Current Account at 79.4 billion, Hajj Savings at 263.9 billion, and Barokah Time Deposit at 1,552.2 billion.



Non-Performing Financing (NPF)

The bank provides financing as shown in Table 1. The data indicates that the NPF at Bank Jatim Syariah is well below the maximum NPF limit of 5% set by Bank Indonesia. The number of Non-Performing Financing (NPF) - Gross at Bank Jatim Syariah in 2019 was 30,579,930,856.86 with 110 debtors, or 2.18% of the total financing disbursed of 1,401,832,677,514.70 with a total of 6,566 debtors. The data shows that the NPF of Bank Jatim Syariah is far below the maximum NPF limit set by Bank Indonesia of 5% of total financing.

Table 1. Financing and NPF of Bank Jatim Syariah 2015-2019
(in million rupiah)

No.	Year	Total Financing	Collectability 3-5	% NPF
1	2015	719,906	14,165	1.97%
2	2016	823,235	17,306	2.10%
3	2017	919,134	21,623	2.35%
4	2018	1,119,662	24,413	2.18%
5	2019	1,401,832	30,599	2.18%

(Source: Bank Jatim, 2019)

In 2019, there were 8 non-performing financing debtors that were restructured with a non-performing financing value of 5,074,223,960. Additionally, there was 1 non-performing financing debtor who failed to pay, and the collateral was auctioned. However, the debtor did not accept the auction sale value and took the matter to court, with the remaining financing amounting to 1,904,367,495.

As an intermediary institution, the risks faced by Bank Jatim Syariah are similar to those faced by other banks. One of the primary risks is non-performing financing, which can occur due to external and internal factors of the customer. These factors are the most dominant at Bank Jatim Syariah, as stated by Sohibul Iman, an official of the bank:

In general, the factors that cause non-performing financing at Bank Jatim Syariah are the ability and willingness to pay obligations/installments that are not fulfilled by customers. In terms of willingness to pay, there are certain areas, such as in Sampang Regency, where some debtors do not want to pay. This is not because they are unable to pay, but because of the character of the person, the character of the person does not want to pay.



Based on Table 1, it can be seen that the financing issued by the bank increases year by year. Likewise, the number of problematic financing in the category of collectability 3-5 also tends to increase, although with a balanced ratio. This increase is a concern for the bank, prompting preventive and corrective steps to handle financing in the future. The number of non-performing financing cases at Bank Jatim Syariah tends to increase in line with the financing, as shown in Table 2. However, the increase at certain stages is considered reasonable based on the information provided by the financing committee team.

Table 2. Collectability of Bank Jatim Syariah 2015-2019
(in million rupiah)

No.	Description	2015	2016	2017	2018	2019
1	Col 1	690,798	782,910	862,059	1,064,702	1,328,659
2	Col 2	14,924	23,018	35,451	30,546	42,593
3	Col 3	2,238	1,851	5,150	2,991	4,237
4	Col 4	646	7,207	1,072	5,811	6,278
5	Col 5	11,281	8,247	15,399	15,609	20,053

(Source: Bank Jatim, 2019)

Causes of NPF

The primary cause of NPF is customer's inability or unwillingness to repay installments. This is most prevalent in the consumptive sector, where financing relies on fixed income. Unexpected income deficits can easily lead to delinquencies. In the context of analyzing non-performing financing within the Col 3-5 category, financial institutions undertake a multi-faceted approach. As noted by Prasetyo P, another official at Bank Jatim Syariah, collectability extends beyond simply identifying delinquent customers. It necessitates a comprehensive evaluation process that considers various customer segments. He stated:

"The concept of collectability does not directly relate to declining customers, but it does involve several issues. These issues need to be analyzed to find the best solutions, considering the diverse types of customers. There are customers who are good and remain good for the business, and there are customers who start off good but eventually decline. Therefore, continuous monitoring and evaluation are necessary. A customer might be a good person and their business might be thriving at first, but without proper monitoring and evaluation, they could end up declining. There are also customers who are discarded, customers from other banks who experience collectability issues. These customers are



financially healthy but are taken over by Bank Jatim Syariah. Accepting customers like this requires caution and in-depth analysis. It's not uncommon for the first and second installments to go smoothly, only for subsequent payments to falter. So, there are several factors to consider: even good customers can decline if they are not properly maintained."

This analysis acknowledges the existence of a spectrum of customer behavior. While some customers consistently demonstrate a positive repayment history, others may initially perform well but subsequently experience difficulties. These customers require ongoing monitoring and reassessment to mitigate the risk of delinquency. The potential for a customer's financial situation to deteriorate, despite initial positive indicators, underscores the importance of such vigilance.

Furthermore, the analysis recognizes the presence of "discarded customers," individuals who have faced collectibility issues with other financial institutions. Despite these customers seeming financially stable, their incorporation into a new institution, such as Bank Jatim Syariah, calls for a careful and comprehensive analysis. These customers often exhibit a pattern of making initial payments, followed by non-payment, which underscores the need for a multi-factorial risk assessment. Therefore, it is important to note that due to the key factors contributing to non-performing financing, even customers with a previously positive performance record can become delinquent if not properly monitored and managed.

NPF Resolution Strategies

Bank Jatim Syariah implements a structured rescue strategy when faced with problematic financing situations. This strategy, as outlined by Shohibul Iman (2020), involves a progressive series of steps:

1. Early Intervention

The initial phase focuses on communication with the customer. This includes issuing verbal and written warnings, followed by direct contact attempts. Iman explained that:

"Verbal and written warnings are issued, and customers are contacted. If the customer still has the capacity to pay, albeit reduced from before, efforts are made to save the financing or restructure it. If the customer lacks the ability to pay, it is recommended to jointly sell the collateral



and/or put it up for auction. The final step, if necessary, is the execution of the collateral.”

2. Financing Rescue

If the customer retains some repayment capacity, restructuring efforts are undertaken. This often involves rescheduling the financing terms through a new contract, typically extending the repayment period. Additional costs associated with this process include notary fees and extended insurance coverage. The bank employs a rescue strategy that includes verbal and written warnings, customer contact, and restructuring when feasible.

3. Specialized Recovery Teams

To address delinquent accounts, Bank Jatim Syariah assigns dedicated teams based on the severity of the issue. Collectability categories 1 and 2 are handled by branch-level teams, while more critical situations (categories 3, 4, and 5) are managed by a specialized unit. Iman stated:

“To manage collectability categories 1 and 2, a separate team (handling branch) was established, while a special team was formed for categories 3, 4, and 5. The purpose of financing rescue is not solely to benefit the bank, but also to alleviate customer difficulties. This is carried out in accordance with the customer’s ability. For instance, installments may be reduced from 5 million to 2 million, the period may be extended from 5 years to 15 years, or the profit sharing could be adjusted. For example, if the initial profit sharing was 60% for the bank and 40% for the customer, it could be changed to 40% for the bank and 60% for the customer. However, such a process can lead to additional costs due to the need for a new contract, additional provisions, and administrative expenses.”

4. Customer-Centric Approach

The bank prioritizes a collaborative approach to resolving financing issues. Restructuring options are tailored to the customer's specific circumstances, potentially involving adjustments to installment amounts, repayment periods, or profit-sharing ratios. While this approach benefits the bank by salvaging the financing, it also aims to alleviate customer hardship. Eko Cahyono as PPPS Junior Officer and Resza, HKS Officer, stated that:



“If customers wish to expedite the repayment of non-performing financing, Bank Jatim Syariah can offer relief by reducing or eliminating margins, fines, or *ta'wid* (compensation), or a combination of these. If payments are not made, an auction of the collateral will be initiated. However, Bank Jatim Syariah first provides customers with the opportunity to sell the collateral themselves, granting a period of 6 months to 1 year for this purpose. If self-sale is not feasible, the collateral will be sold jointly by the bank and the customer. A special team has been established to evaluate the collateral's price, which is determined in three stages: 1) initial stage with a high price, 2) fair or market price, and 3) liquidity price. If these methods are unsuccessful, the collateral will be auctioned. From the registration to the auction process, the customer is informed at each stage.”

According to Prasetyo Anto, the PBO Supervisor at Bank Jatim Syariah, restructuring does not wait until collectability reaches 3, 4, or 5; it is initiated as early as collectability 1 and 2 to save the condition of the bank and help customers overcome their difficulties. Similarly, Eko Cahyono and Resza emphasize that restructuring is carried out in collectability positions 1 and 2 without waiting for more severe stages. Bank Jatim Syariah employs three methods of restructuring: scheduling (rescheduling), reconditioning, and restructuring. While the Financial Services Authority (POJK) allows restructuring twice, Bank Jatim Syariah typically does it once. If customers wish to pay off NPF faster, the bank may offer relief by reducing or eliminating margins, fines, or compensation (*ta'wid*).

5. Proactive Restructuring

Prasetyo Anto, the PBO Supervisor at Bank Jatim Syariah, emphasizes a proactive approach to restructuring. He advocates for initiating restructuring efforts as early as Collectability stages 1 and 2, not solely waiting until later stages. This underlines the bank's commitment to both financial stability and customer support, prioritizing the rescue of financing agreements whenever feasible. He emphasized that:

“the bank does not necessarily wait for accounts to reach advanced delinquency stages (Collectability 3-5) before initiating restructuring efforts. Intervention can occur as early as Collectability 1 or 2, aiming to prevent further deterioration and preserve the financial health of both the bank and the customer.”



When restructuring efforts fail, the bank may proceed with a collateral auction to recover outstanding amounts. Initially, customers are given 6 months to 1 year to sell the collateral independently. If unsuccessful, the bank and customer jointly sell the collateral. A special team assesses the collateral's price in three stages: high price, fair/market price, and liquidity price. If these efforts fail, the collateral is auctioned. The collateral auction process is often lengthy and challenging, particularly for properties in non-urban areas. Shohibul Iman explains that some collateral, such as shop houses in Kraksaan Regency, have been auctioned for years without success due to location and market conditions. For more severe cases, legal action may be taken. During the period of 2015-2019, only one case at Bank Jatim Syariah went to court, involving a nominal value of IDR 1,904,367,495.

Table 3. Restructuring of Bank Jatim Syariah 2015-2019 (in million rupiah)

No.	Year	Amount of Customers	Total Liabilities
1	2015	0	0
2	2016	0	0
3	2017	1	554,924,008
4	2018	13	6,751,184,869
5	2019	8	5,074,223,960

(Source: Bank Jatim Syariah, 2019)

Discussions and Research Implications

The aforementioned results discuss the financing management and non-performing financing (NPF) at Bank Jatim Syariah, highlighting several key findings with important research implications. These findings can be related to previous studies in the field of Islamic banking and finance.

First, the bank's proactive restructuring strategy, initiated as early as collectability 1 and 2, suggests that early intervention can significantly reduce NPF and improve loan recovery rates. This finding aligns with previous studies that have emphasized the importance of proactive risk management in Islamic banks (Elgari, 2003; Abedifar et al., 2013). In the post-pandemic context, where many customers may face financial difficulties due to economic disruptions, early intervention and restructuring could play a crucial role in mitigating NPF and supporting economic recovery. Further research could explore the effectiveness of different restructuring approaches in the post-pandemic era,



considering the unique challenges and opportunities presented by the current economic landscape.

Second, the difficulties encountered by Bank Jatim Syariah in collateral auctions highlight the challenges of collateral-based lending, particularly in non-urban areas. This finding resonates with existing literature that has discussed the limitations of collateral as a risk mitigant, especially in the context of market illiquidity and valuation difficulties (Ariffin et al., 2009; Ismal, 2010). In the post-pandemic world, where property values may fluctuate and market conditions remain uncertain, the challenges associated with collateral auctions may persist or even intensify. Future research could explore alternative risk mitigation strategies and innovative approaches to collateral valuation that are more resilient to economic shocks and market disruptions.

Third, the text mentions customer unwillingness to pay as a contributing factor to NPF in certain areas, suggesting that customer behavior and socio-cultural factors play a significant role in credit risk management. This finding aligns with previous studies that have explored the impact of customer behavior on loan repayment in various contexts (Roslan & Karim, 2009; Mokhtar et al., 2012). In the post-pandemic era, where economic hardships may exacerbate issues of willingness to pay, understanding the influence of cultural and social factors on financial behavior becomes even more crucial. Future research could investigate how Islamic banks can tailor their risk management strategies and customer engagement approaches to address these behavioral factors effectively in the post-pandemic context.

Furthermore, the findings highlight the importance of balancing financial performance with social responsibility in Islamic banking. Bank Jatim Syariah's customer-centric approach and efforts to assist customers in overcoming financial difficulties align with the ethical principles of Islamic finance (Haniffa & Hudaib, 2007; Dusuki, 2008). In the post-pandemic world, where social and economic inequalities may widen, the role of Islamic banks in promoting financial inclusion and social welfare becomes even more critical. Future research could explore how Islamic banks can adapt their strategies to better serve vulnerable communities and contribute to a more equitable and sustainable economic recovery.

Lastly, the challenges faced by Bank Jatim Syariah in writing off non-performing loans due to its ownership structure and accountability to regional



government stakeholders raise important questions about the governance and regulatory framework of Islamic banks. Previous studies have discussed the importance of effective write-off policies and regulatory compliance in Islamic banks (Siddiqui, 2010; Errico & Sundararajan, 2002; Wardiah, & Ibrahim, 2013). In the post-pandemic era, where financial stability and regulatory compliance may face new challenges, the experiences of Bank Jatim Syariah underscore the need for further research on balancing the competing demands of regulatory requirements, stakeholder interests, and financial sustainability in the Islamic banking sector.

While the data from Bank Jatim Syariah covers the pre-pandemic period, the findings offer valuable insights that remain relevant in the post-pandemic context. The bank's proactive approach to NPF management, customer-centric focus, and challenges in collateral auctions and write-offs highlight important areas for further research and policy development in the Islamic banking sector. By adapting these strategies to the unique challenges and opportunities presented by the post-pandemic era, Islamic banks can contribute to a more resilient, inclusive, and sustainable economic recovery.

CONCLUSION

This study examined the financing management and non-performing financing (NPF) practices of Bank Jatim Syariah in Indonesia from 2015 to 2019. The key finding is that Bank Jatim Syariah consistently maintained a low NPF ratio, remaining well below the 5% threshold set by Bank Indonesia. This success can be attributed to the bank's proactive approach to NPF management, which emphasizes early intervention through restructuring initiatives at the first signs of delinquency. The bank's commitment to a customer-centric approach, demonstrated through flexible restructuring options tailored to individual customer circumstances, aligns with the ethical principles of Islamic finance.

Despite its success in maintaining a low NPF ratio, Bank Jatim Syariah faces challenges in managing NPF, particularly with collateral auctions and write-offs. The lengthy and complex process of auctioning collateral, especially in non-urban areas, highlights the limitations of collateral-based lending and the need for alternative risk mitigation strategies. Additionally, the bank's ownership structure and accountability to regional government stakeholders create obstacles in writing off non-performing loans, highlighting the need to balance regulatory compliance with financial sustainability.



This study is limited by its focus on a single institution and a pre-pandemic timeframe. Future research should expand upon these findings by investigating the NPF management strategies of other Islamic banks, particularly in the post-pandemic context. Further research should also explore alternative risk mitigation strategies beyond collateral-based lending, investigate the impact of socio-cultural factors on customer repayment behavior in Islamic finance, and examine the role of Islamic banks in promoting financial inclusion and social welfare in a post-pandemic world. By addressing these areas, future research can contribute to a more comprehensive understanding of NPF management in Islamic banking and its role in supporting a resilient and inclusive economic recovery.

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