

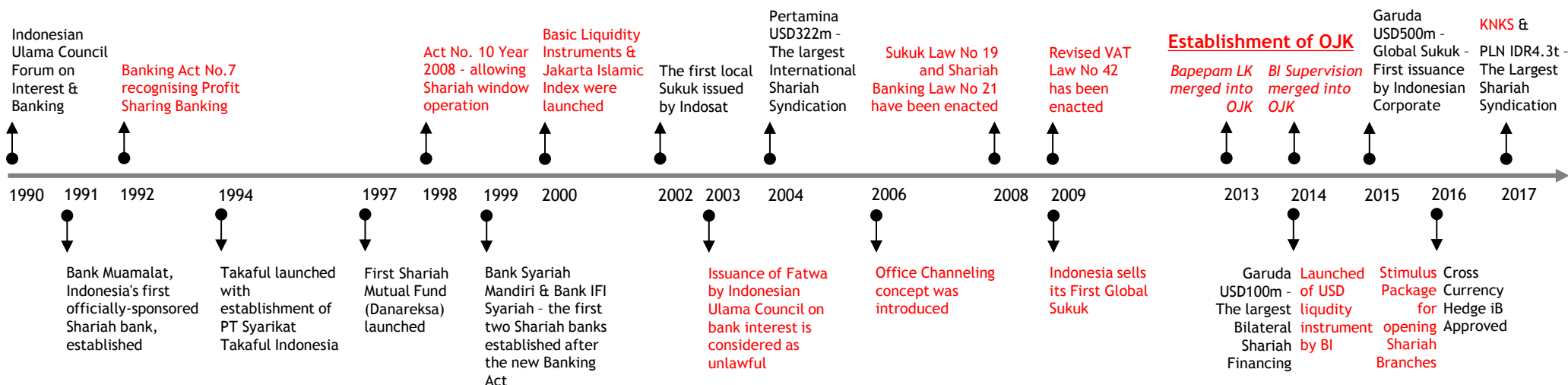
**A quarter of century  
of Islamic banking existence in Indonesia:  
*contemplation from a practitioner point of view***

Jakarta - 19 March 2018

# Shariah Finance: Huge Potential but Very Slow Growth

## *Needs strong coordinated push from government to accelerate the growth*

**Market Share of Shariah Banking is only at 5.4% (or USD30.7bio) as of December 2017**



- Indonesia possesses key ingredients to play an important role in Shariah Finance globally: strategically located, large population, abundant resources, resilient, diversified & sizeable economy, and a matured democratic country with plenty of infrastructure projects to be financed
- Shariah Finance can play an important role in the development of the infrastructure projects by helping diversify the investor base
- With its huge retail & SME businesses and newly developed investment banking business, Indonesia is set to be the Global Islamic financial hub - attracting FDIs and facilitating Indonesian Shariah Financial Institutions to compete in the global arena
- However, the industry needs a systematic approach in addressing its challenges: Orchestrated Push from the Government, Regulation, Innovative Shariah Structures, Liquidity & Hedging Instruments, Significant Supporting Industries, & Sizeable Corporate Sukuk market

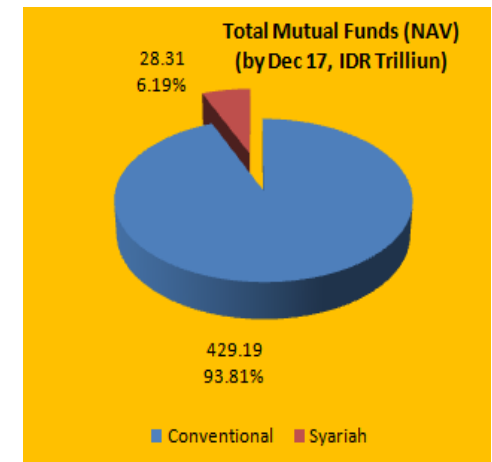
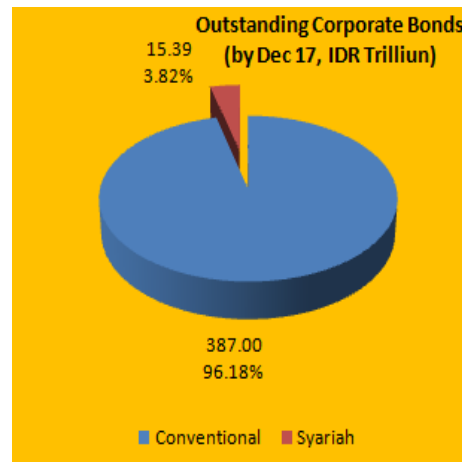
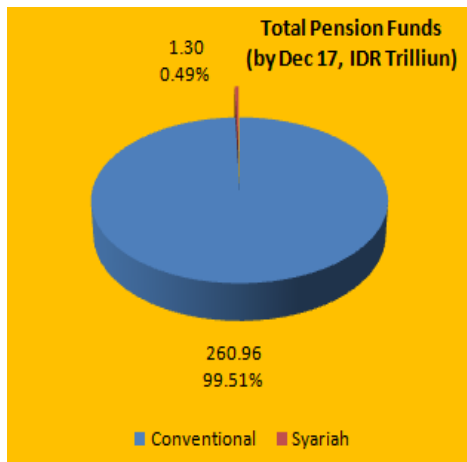
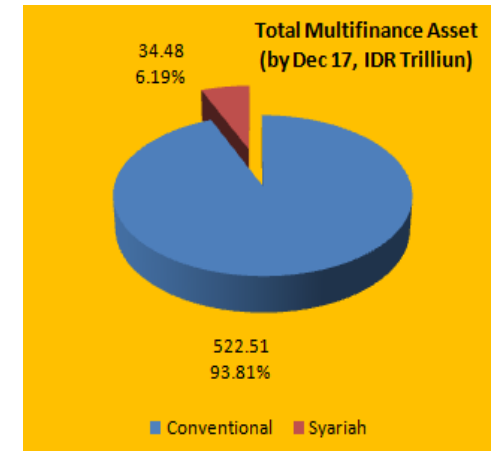
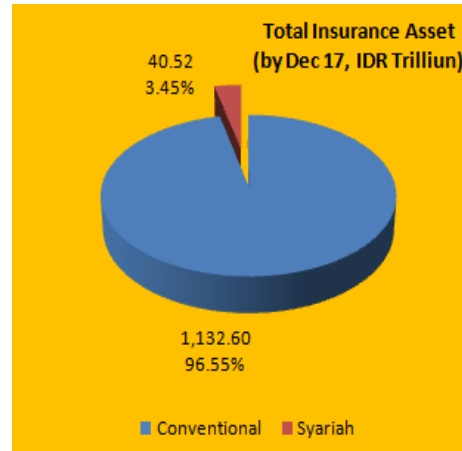
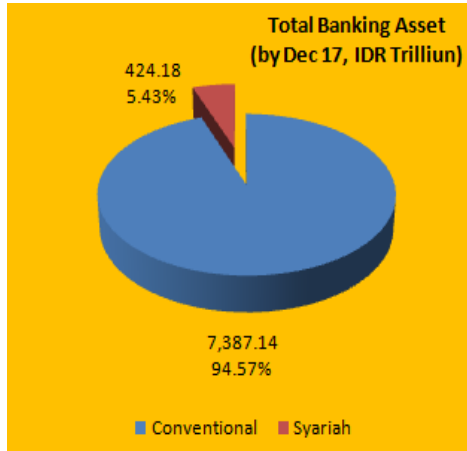
Source: Various sources

# Snapshot of the Industry

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# Small Scale Economy despite Years of Development

*Economies of Scale have not been achieved - making it difficult to compete with conventional*

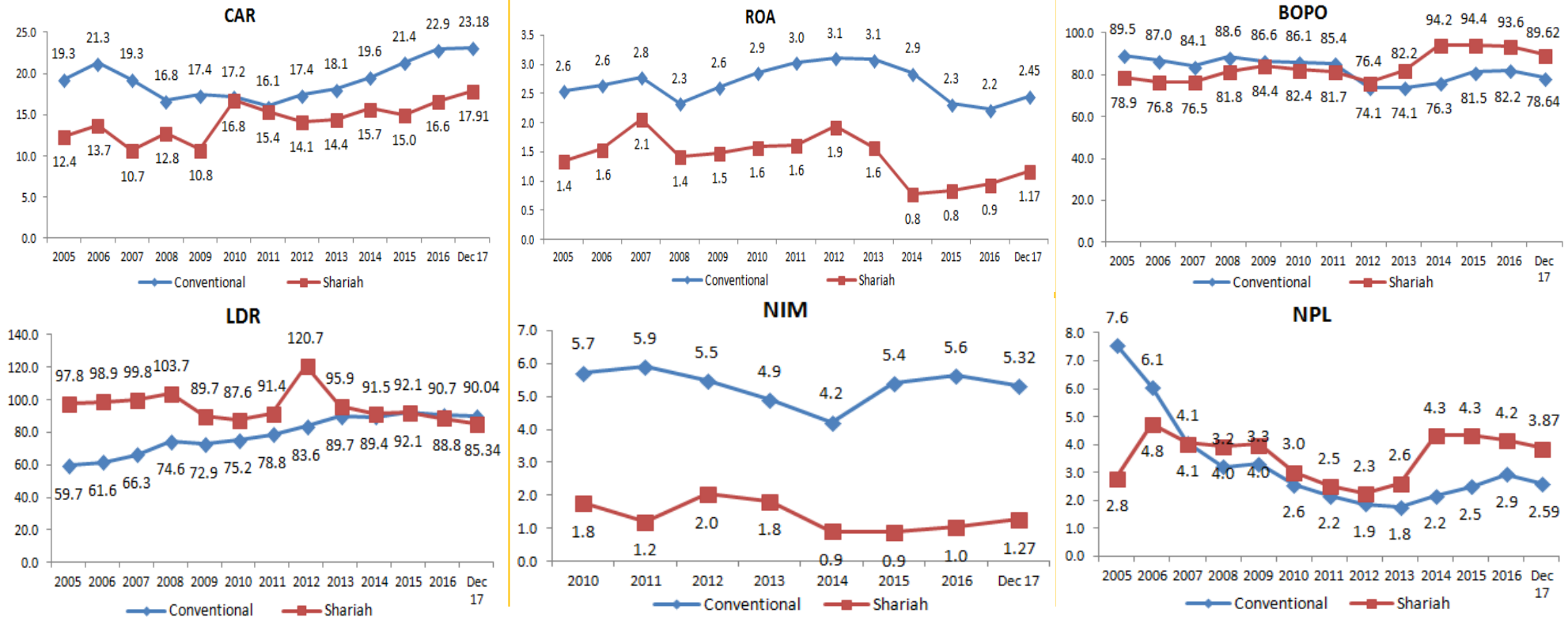


Source: OJK website - Data & Statistic (Dec 2017)

# Key ratios show gloomy trends but these shall be improving

*High COF, limited skilled professionals & products hinder Shariah banks to outperform conventional*

## Financial Ratios Comparison



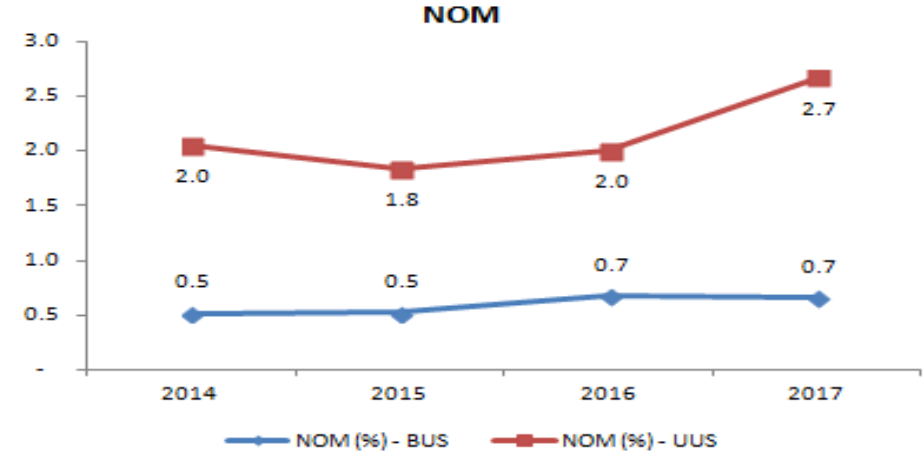
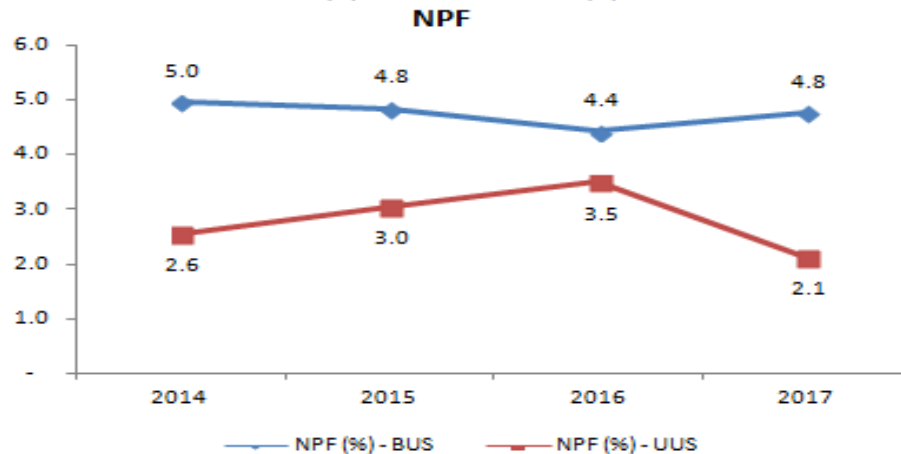
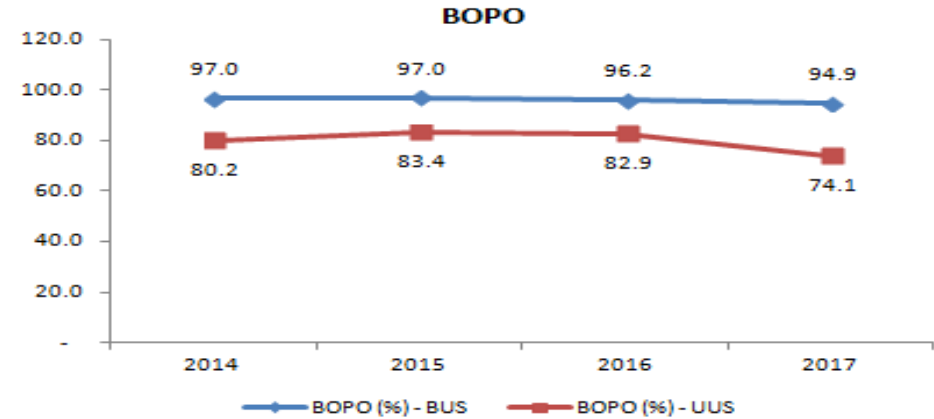
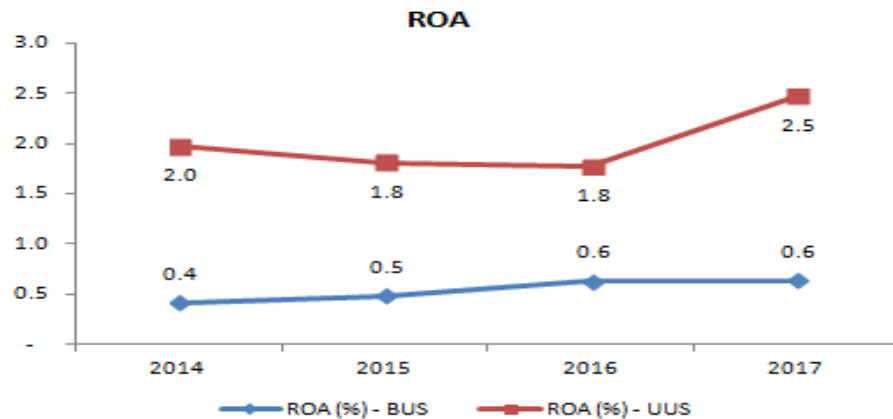
- Overall financial indicators are lower than conventional since; difficulties in raising funds from debt & capital market (to improve CAR), limited fee based income products hence relying heavily from financing to generate revenue (hence lower ROA) and lower productivity (as a result of limited products, branch expansion & smaller ticket size financing) – resulting to higher BOPO
- LDR is converging since (Shariah) requirement to maintain FDR at least 80% to be able to place excess funds to SBIS & (conventional) requirement to maintain LDR above 80%
- NPL is deteriorating mainly due to structural issues i.e. high COF pushing the management to take riskier assets, inexperience employees when it comes to dealing with commercials/corporates, and poor governance (note that, at the early stage of the industry, the financing portfolio was still well below 5yrs/has not passed its vintage yet & the financing continued to grow exponentially hence resulting in lower NPF)

Source: Indonesian Banking Statistics (Statistik Perbankan Indonesia) December 2014 - Dec 2017

# Shariah Business Units continue to outperform Shariah Banks

*Fully leveraging the conventional resources is the main reason of this strong performance*

- Across key financial ratios (ROA, Operational Expense Operational Income/BOPO, NPF and NOM), UUS performs better than BUS. This is because UUS has a key advantage in leveraging on all its conventional resources
- In addition, among the key challenges faced by BUS are difficulties in attracting good talents & competitive funding, reducing operational costs, and limited products & network



Source: Indonesian Banking Statistics (Statistik Perbankan Indonesia) December 2014 - Dec 2017

# The Opportunities

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# Funding: Hajj & Pension Funds

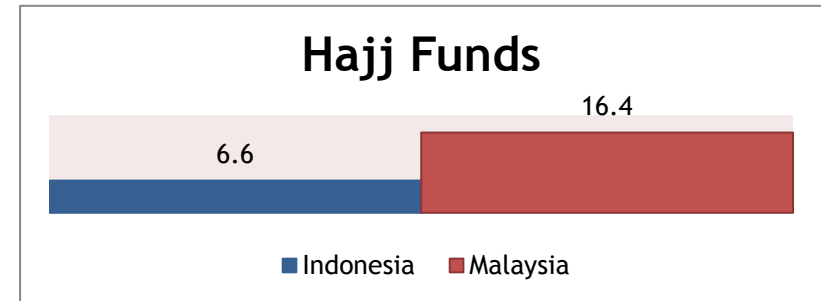
*By law, Hajj Funds has to be invested in Shariah compliant investments*



## Hajj Funds *Comparison*

*Billion USD - Dec 2016*

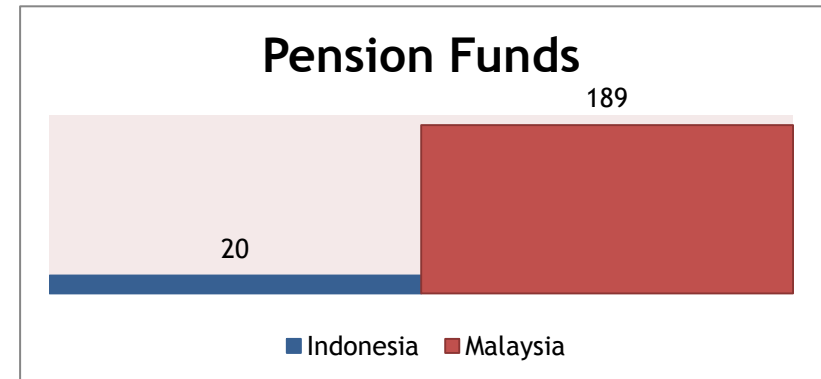
Financial	Indonesia	Malaysia
ASSETS	6.6	16.4



## Pension Funds *Comparison*

*Billion USD - Dec 2016*

Financial	Indonesian BPJS TK	Malaysian EPF
ASSETS	20	189



- Hajj Funds in Malaysia has been managed properly since 1969. The waiting period for Hajj travelers is on average 35-40 years (vs. in Indonesia of avg. 17yrs)
- EPF contribution in Malaysia is at least 23%: 11% from employee & 12% from employer (vs Indonesia of 5,7%: 2% & 3.7%, respectively)
- More than 45% of EPF's total investment assets are already Shariah compliant - helping to boost Shariah Finance in Malaysia
- Privately managed Pension Funds has been excluded. In Indonesia, USD 16.4 billion is managed by privates and only 1% is invested in Shariah compliant instruments
- These sources of funds are ideal to support long term project financing

Source: OJK & Kemenag website, BPJS TK, Tabung Haji & EPF Annual Report



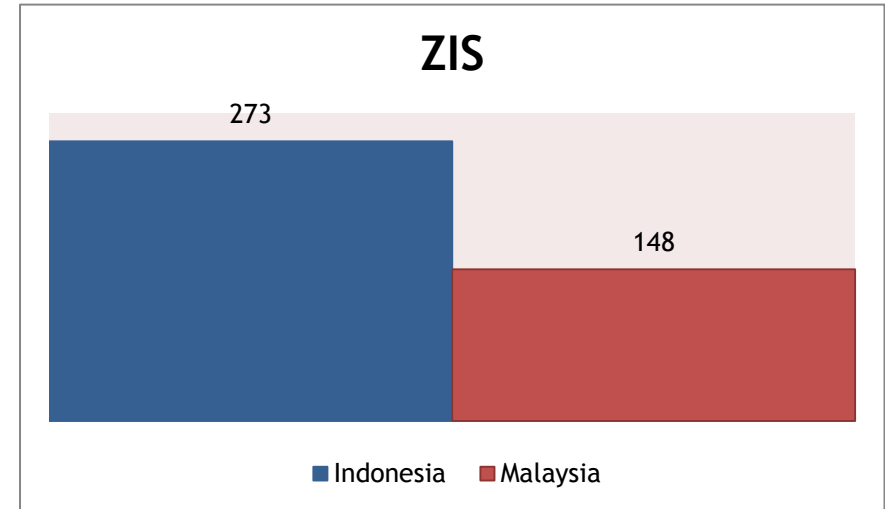
## Funding: Zakat, Infaq, Shadaqah & Waqf

*If properly administered, ZIS Waqf can be source of liquidity for Shariah Finance*



### ZIS Comparison

Mill USD - Dec 2016	Indonesia	Malaysia
ZIS	273	148



- In Malaysia, Zakat Payment can be used as a component to deduct the Tax Payable amount. Institutions owned by SOEs or Muslim, or in the form of an Islamic Financial Institution, are also paying Zakat
- Waqf (both fixed assets and Waqf Funds) have not been taken into the consideration due to the absence of reliable data. However, it is believed that this is also another huge potential for Shariah Finance to tap especially in meeting the land waqif and the financier to develop a plot of land for a commercial complex (as practiced in Singapore)

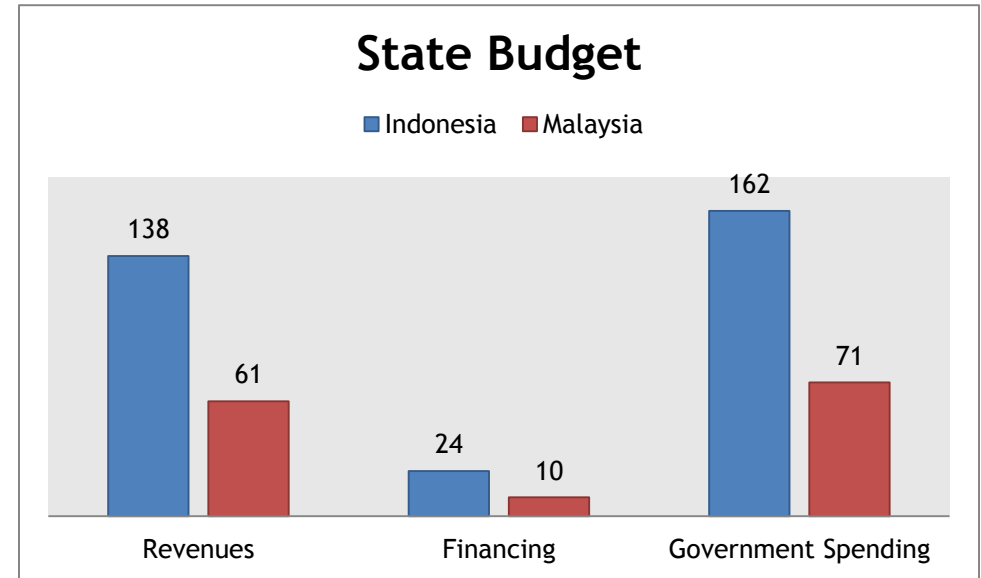
## Funding: State Budget

*Portion of State Budget shall also be channeled through Shariah banking*



### State Budget *Comparison*

<i>USD bio - Dec 2017</i>	Indonesia	Malaysia
Revenue	138	61
Financing	24	10
Government Spending	162	71

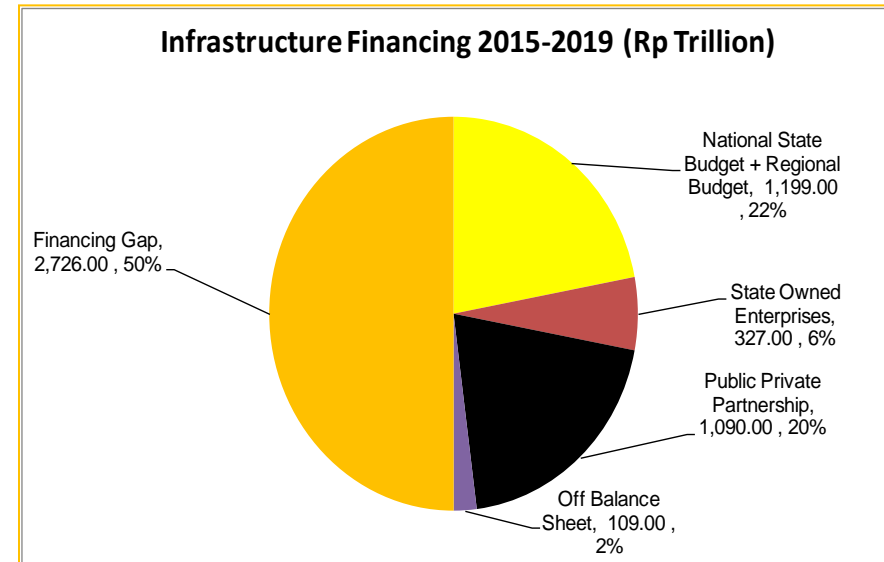


- Funds from the Malaysian government to sponsor all religious related activities have to be managed as per Shariah principles
- SOEs are also encouraged to place their funds into Islamic Financial Institutions or Shariah compliant instruments. The financing is also encouraged to be Shariah compliant
- Early 2016, Indonesia has just opened up SOE Islamic banks to manage the payroll of government officers

# Financing: Infrastructure Projects

*Current government needs USD416billion to develop infrastructures from 2014-2019*

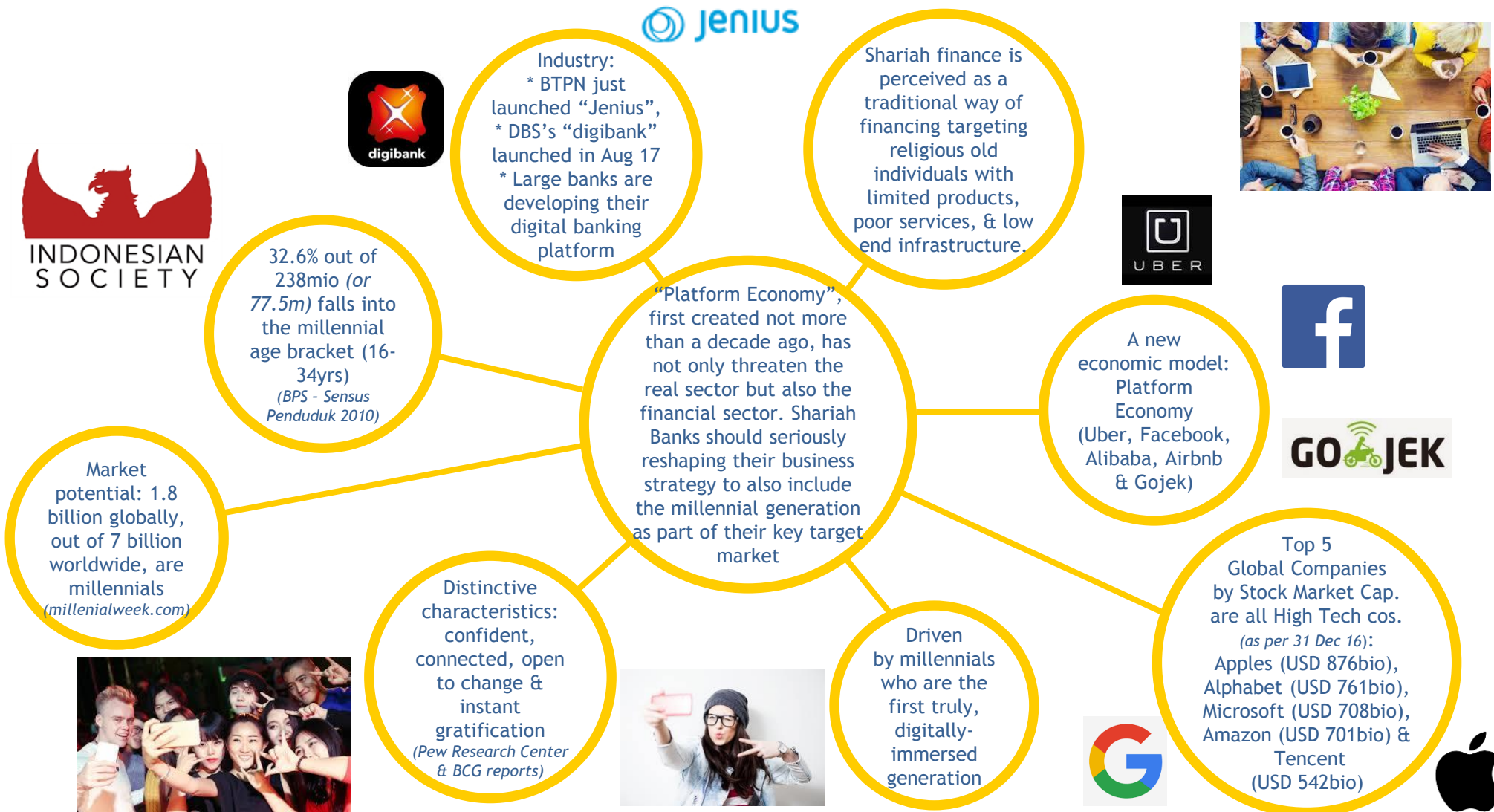
No	Infrastructure Project in 2015-2019	Worth Project (Rp Bn)	% of Total
1	Roads	851	16
2	Railways	222	4
3	Urban Transportation	115	2
4	Sea Transportation	424	8
5	Ferry and ASDP	80	1
6	Aviation	165	3
7	Electricity	1,080	20
8	Energy and Gas	420	8
9	Water Resources	845	15
10	Clean Water and Waste	666	12
11	Housing	384	7
12	Communication and IT	200	4
<b>Total Investments</b>		<b>5,452</b>	<b>100</b>



- Ambitious infrastructure projects that has been estimated to reach IDR 5,452 Trillion in 2014-2019. Power, road, and water resources are the top priorities as they account for half of the total project's fund
- In terms of shares of the financing scheme, the National Planning Agency expects the following: Central and Regional Government (20%), SOE (6%) and Public-Private Partnership/PPP (20%). The remainder will be filled by Private Sector. Private Sector is expected to have big role to finance the infrastructure projects
- Thus, it is believe that foreign direct investments, loans, and the capital market will be important sources of infrastructure financing going forward. Hence, Shariah Financial Market should not only prepare their capability in, but most importantly, play important part in financing the infrastructure projects

# Last but not Least: The New Economic Platform

3 out of Top 5 Global Companies were established not more than 25yrs ago



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# The Contemplation

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# Indonesia deserves to be the Global Islamic Finance hub

*An orchestrated support from stakeholders shall be able to move this agenda forward*

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1. Urgently need to address the structural issues faced by Shariah banks since size does matter
  2. Leverage model is key for a healthier and profitable Shariah Commercial Bank (BUS)
  3. In addition to fund management for Islamic religious activities (such as ZIS Waqf), management of pension funds and State Budget shall also be partially invested/channeled through Shariah banks
  4. Shariah banks can actively participate in government infrastructure projects. Focusing on Retail and Micro SME only will hamper the bank/industry to properly diversify its portfolio
  5. Last but not least, the industry urgently needs good talents, not only to reignite healthy & strong growth but also to compete with the new economic platform
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**Thank You**

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