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# Indonesian Islamic microfinance in the ASEAN Economic Community era

The idea in establishing the ASEAN Economic Community (AEC) in 2015 began with the desire of ASEAN countries to establish ASEAN as a solid regional economy and a strong international economic area. ASEAN leaders' agreement was established on four pillars: (i) a single market and production base, (ii) a highly competitive economic region, (iii) an equitable region for economic development, and (iv) a fully integrated region with the global economy. The objectives of AEC are the free flow of goods, services, skilled labor, as well as free investment. BAYU TAUFIQ POSSUMAH delves further.



## ISLAMIC MICROFINANCE

By Bayu Taufiq Possumah

In its application at the end of 2015, AEC will implement 12 priority sectors — agro-based products; air travel (air transport); automotive; e-ASEAN; electronics; fisheries, health care; rubber-based products; textiles and apparel; tourism; wood-based products; and logistics, as well as the food, agriculture and forestry sectors. Free trade includes the reduction and elimination of tariffs and non-tariffs significantly in accordance to the Asean Free Trade Area scheme.

Improvement in international trading facilities are expected to accelerate free trade such as customs procedures through the establishment and implementation of the ASEAN Single Window or Customs electronic systems, evaluating the Common Effective Preferential Tariff Scheme and the Rules of Origin or a letter of good origin, as well as harmonizing standards and conformance. All of these eliminate trade barriers among ASEAN countries and will greatly affect the economic growth and development of every country in the region in general, particularly for business institutions such as SMEs or microfinance.

In Indonesia, SMEs have a strategic role and greatly contribute to the national economy by contributing 53.3% of the total GDP. The number of SMEs in Indonesia reached around 56.2 million units and is able to absorb 97.2% of the existing total labor force. But the big question is: is Islamic microfinance ready to face the AEC? While the reality of the economic level in Indonesia is still below expectations, issues regarding layoffs, unemployment and the poor are still flaring and even when dealing with domestic products, the community tends to choose foreign-made products.

This is why some economists believe that Indonesia will become the market made by other countries where foreigners take over the domestic markets making Indonesians as mere consumers, which in turn could have an impact on the shrinking revenues of the country.

For Indonesian Islamic microfinance, the establishment of the AEC will provide some challenges not only internally in the country but also externally in competition with other ASEAN countries and countries outside ASEAN like China and India. The intense competition is likely to impact competitive pricing, not just in commodities/products/services, but in the microfinance sector as well because of the similarity of product characteristics. Considering the role of SMEs as a business group that has the biggest number and is dominant in the economy, the AEC will also be influenced by the readiness of Shariah-based microfinance. Contributions from SMEs to the Indonesian GDP is 47%. From Indonesian revenue of about IDR1 trillion (US\$71.3 million), SMEs contributed about IDR430 billion (US\$30.66 million) and this is evidence that Islamic microfinance institutions have greater impact and benefits to society.

In the AEC era, there are some things that must be considered by the Indomobil Finance Indonesia (IMFI) to maintain its existence and improve its performance as follows.

## Core competencies development

The core competencies are a set of unique capabilities developed in some key areas such as quality, customer service, innovation, team-building, flexibility and the ability to outperform other competitors. In connection with the AEC, the core competencies development of Shariah-based SMEs at least should focus on three aspects: human resources,



infrastructure, and business insight. This is because Shariah-based SMEs or Islamic microfinance are generally not much different from the Program for Community-Based Livelihood Improvement which is facilitated by the National Program for Community Empowerment Mandiri in Indonesia, since the crucial spot is the strength of independent community groups to develop their potential. The only difference is the contract and revenue-sharing system between practitioners of microfinance itself.

## Product diversification

Market expansion really affects the strength of Islamic microfinance. Therefore, there are several points to ponder by the Islamic microfinance industry for market expansion as follows:

- Technology – with technology, the Islamic microfinance industry can assure a lot of advantages such as time efficiency and easier production processes which will make the Islamic microfinance industry to be more profitable.
- Qualified human resources – in order to get quality results, we need qualified human resources who are on par with innovation, creativity and foster good relationships with others. Thus, the recruitment of the workforce must be very tight to get competitive human resources.
- Government efforts – with scattered natural resources, creative innovation would bring remarkable results in

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the Islamic microfinance industry's performance and be able to compete in the AEC. Hence, the government's efforts are required to improve the quality and competitiveness of the Islamic microfinance industry through Halal certification, ISO, and such. The Islamic microfinance industry IMFI also needs to synchronize their programs in line with the government's policies.

## Regulation support

In the context of the Indonesian Islamic microfinance industry facing the AEC, one important component to take note is how the government-issued policies can protect (but not merely protective) the Islamic microfinance industry. This means the government should give wider flexibility to the Islamic microfinance industry to grow in the ASEAN economic community atmosphere. For example, in cases of limited access to finance where Shariah banks are still hesitant in lending to the Islamic microfinance industry (due to the cost of funds, the company's profits, the risk profile of the Islamic microfinance industry, and business sectors), the government needs to proactively provide education and training to improve the financial performance of the Islamic microfinance industry. To reinforce the SME sector, the government is expected to increase more funds to SMEs from the Regional Government Budget and the National Government Budget. About 5% of the budget specifically for the development of the microfinance sector is very helpful in strengthening the industry.

The aforementioned actions can realize a powerful and professional Islamic microfinance industry in terms of providing institutions and agents for community development, asset distribution, people empowerment especially in uplifting the poor, creating vast employment opportunities, building business networks, equitable distribution of development outcome as well as providing effective and efficient financial services to the public in the face of the AEC or free market competition.<sup>(3)</sup>

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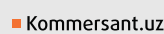
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