PROFIT SHARING SCHEME FOR MICRO ENTREPRENEUR:

AN IDEAS SHARING

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Profit sharing financing is one of Islamic financing schemes. This scheme should be a main scheme in Islamic financing sector, because it represents fairness business scheme, which each partner will share both profit and loss. But the reality is different. Most of Islamic financing scheme in Indonesia is not profit sharing (mudharabah/musyarakah)2, but mark up financing (murabahah). Murabahah scheme is financing scheme which customer proposes for Islamic Financial Institution to finance an asset, Islamic Financial Institution will buy the asset from supplier at certain price and sell to the customer in higher price (mark-up financing). Customer will pay the asset at "fixed" price in certain financing period.

Due to my experience, one of the problems of this condition is "adverse collection". If the customer business is a start up company/new entrepreneur, the business risk is rather high and the profit is still low, - because lack of business experience -, the collateral is insufficient. In the situation where he/she has no collateral, the customer prefers profit sharing financing scheme (mudharabah/musyarakah) rather than mark-up financing scheme (murabahah). This is due to the need of the customer to share its risk. On the other hand, Islamic Financial Institution will avoid profit sharing scheme and prefer to use mark-up financing, because the business is too risky on their term.

However, when the business customer has been rather stable, has higher profit, and has sufficient collateral, thus the business risk becomes more manageable. This customer will prefer mark-up financing (murabahah) rather than profit sharing financing (mudharabah/musyarakah). This is due to the fact that the customer becomes hesitant to share its profit since the value will be greater than they need to pay in mark-up financing scheme. On the other hand, Islamic Financial Institution will prefer to apply profit sharing financing (mudharabah/musyarakah) rather than mark-up financing (murabahah), because the customer has enough experience to manage risk and return and will provide higher return.

Based on this condition, there are some strategies to finance customers using profit sharing scheme (mudharabah/musyarakah).

1. No profit sharing scheme for new customer

In common practice, there is almost no Islamic financial institution will give a new customer with mudharabah/musyarakah scheme. Mudharabah/musyarakah scheme is profit sharing, which Islamic Financial Institution profit is depended on business profit and the business profit can not be predetermined. The Key success factors to implement this scheme are:

* Islamic Financial Institution must know customers' characters quite well. They must feel confident that customers will be transparent and honest in disclosing his/her business revenue/profit, because profit sharing calculation is based on business profit. They will get difficulty to assess new customer character, especially the one who does not have track record Islamic Financial Institution will be easier to assess existing customers characters. His/her compliance to pay financing installment could be one of many indicators.

* As mentioned above, business profits will fluctuate and can not be predetermined. Islamic Financial Institution must predict as exact as possible the business profit to make profit projection analysis. Islamic Financial Institution can not predict it exactly if they has no enough information about their customer business nature/cycles. Islamic Financial Institution also will face difficulties to predict it, because Islamic Financial Institution has not had experience/record with the customer before.

Therefore, Islamic Financial Institution will usually give murabahah scheme for new customers. If Islamic Financial Institution has had enough experience/knowledge about the customers' characters and business natures, they will then consider to apply mudharabah/musyarakah scheme for next financing proposed by the customer.

2. Profit sharing based on business revenue

Actually, the profit sharing object is the profit gathered from the business. Islamic Financial Institution has to control business customer to ensure that they can manage the company efficiently. This is important, because Islamic Financial Institution needs to maintain the customer business profit to be in line with the profit which has been projected by Islamic Financial Institution. In the other hand, in mudharabah/musyarakah scheme, Islamic Financial Institution can not determine maximum cost and or minimum revenue in order to make profit sharing realization equal to profit sharing projection.

3. Profit sharing scheme for high predicted business cash flow (project finance, two-step financing)

To mitigate fluctuative profit sharing that is caused by fluctuative cash flow, commonly Islamic Financial Institution implement profit sharing scheme just for highly-predicted business cash flow. There are two financing types which are implemented in this profit sharing scheme. The first is project financing. In this scheme, Islamic Financial Institution will finance contractor to do certain approved project. Project owner will pay to the contractor base on the progress or turn key basis. The payment from project owner will be the source of financing repayment. It makes Islamic Financial Institution easier to determine profit sharing ratio, because the project amount and term of payment have been stated in the contract/agreement.

The second is two-step financing type in which the Islamic Financial Institution will finance financial institution using profit sharing scheme, and the financial institution will finance end users using murabahah (mark up financing) scheme. The end users will pay the murabahah financing. The repayment consists of principle and profit margin. The principle will repay to Islamic Financial Institution (financers) and the profit/margin is pided between the financial institution and the Islamic Financial Institution based predetermined profit ratio3. For the example, Islamic Financial Institution finance a leasing company using musyarakah. The leasing company finance end users to own motorcycle using murabahah scheme. In this type of financing, Islamic Financial Institution will be easier to project profit sharing, because the profit is derived from murabahah scheme (fixed installment).

What about micro sector? :

Basically micro sector is a business sector that can be identified as follows:

1. The business volume is very small & marginal
2. Most of them don't have sufficient legal formal basis, financial report & fixed asset collateral
3. The using of business fund is overlap between business and inpidual activities

This condition makes some difficulties to implement mudharabah/musyarakah. Mudharabah/musyarakah scheme needs accountability of financial report/record to calculate eventual profit sharing. Profit and loss report will be a basis of profit sharing calculation. On the other side, since the business is very small, implementing technology and or reporting system will be costly for micro entrepreneur. Commonly, micro entrepreneur doesn't calculate the exact business profit. They just know about the sales/income. If we ask them about how much profit they get everyday/every week/every month, most of them can not answer it. It will be easier for them to answer how much their daily income.

Implementing mudharabah/musyarakah scheme for micro sector needs some adjustment, especially to determine profit ratio and to calculate profit sharing.

Revenue sharing instead of profit sharing

Since micro entrepreneur doesn't know about his exact profit, therefore revenue sharing is more suitable than profit sharing. If we are interviewing micro entrepreneur for credit process, we just ask them how much minimum income they earn everyday. Commonly they will answer easily, for example IDR 100.000. Then we simulate installment calculation using certain period and equivalent rate. Say the installment is IDR 30.000 everyday. If they are sure that they are able to pay this amount then we make a deal. We can determine the revenue ratio IDR 30.000/IDR 100.000 = 30%. Collection will be on daily basis, using calculation revenue ratio X daily income.

Scheduled profit sharing

Ideally, in profit sharing scheme, every certain period Islamic Financial Institution and customer will calculate real business profit, and based on it, Islamic Financial Institution will calculate the profit sharing ratio. Since micro entrepreneur doesn't have financial record/report; it can not be done properly. The solution for this problem is "scheduled profit sharing". It means Islamic Financial Institution will make payment schedule for the customer. The customer will pay accordance to the schedule. In this schedule, Islamic Financial Institution will determine minimum revenue projection based on interview/observation result. For example, minimum revenue daily is IDR 50.000, profit ratio for Islamic Financial Institution is 30%, so profit payment daily is IDR 50.000 X 30% = IDR 15.000. It excludes principle payment, so the schedule consists of principle and profit sharing payment. What if the financing is for working capital, does customer have to install the principle? The answer is YES. There are two reasons: (1) customers in micro sector usually prefer to install principle payment(not balloon payment/evergreen financing)4, (2) It is to mitigate financing default at the end of financing period, in case that the customer fail to pay the principle in full. What if the revenue is higher than projection? It is easier, because due to sharia consideration, one party can allocate his profit portion (partial or full) to another party as free will basis. In this case, Islamic Financial Institution will allocate its profit portion partially to the customer. What if the revenue is lower than projection? It will be mitigated through some mechanisms as explain below.

Collection based on business cash flow

Since micro entrepreneurs have difficulties separating the use of fund for business activity from inpidual activity, it is important to collect installment payment based on business cash flow. Usually, micro entrepreneur will earn daily income from the business, so Islamic Financial Institution must collect installment on daily basis. If Islamic financial institution is late to collect it, he or she probably has used the income for inpidual/family need. Islamic Financial Institution should also collect it at customer outlet, because customer usually can not leave his outlet during business hour. While the Islamic Financial Institution collecting the installment in daily basis, they can also provide the customers with their product of savings. In some cases, it makes customer more comfort, because customer can not just pay installment but he can save his money too.

Escrow saving

Islamic Financial Institution can collect escrow saving from customer together with customer installment. Usually, on their schedule, it is added escrow saving portion. So in the payment schedule there are three components: (1) principle, (2) profit and (3) escrow saving. Islamic Financial Institution can withdraw it, to add installment payment if customer doesn't pay in full. Usually, it is caused by decreasing of the customer income. For example, it happens after certain season, such as after Idul fitri, which customer income usually is much lower than before due to the long absent of business activity.

Cash allowance

Commonly, Islamic financial institution will allocate a certain amount as allowance for bad debt/NPL (non performing loan). The allowance will be booked as cost. In micro financing, it is important to allocate the allowance with cash basis not only as an accrual treatment. It means that the Islamic Financial Institution will separate certain amount in cash as allowance. It can derive from part of profit payment. For example, a customer pays installment IDR 50.000 daily, consist of IDR 30.000 as principle and IDR 20.000 as profit. Islamic Financial Institution just books IDR 15.000 as income, and the rest (IDR 5000) will be kept as cash allowance. It will be used in case for NPL recovery.

Flexible installment & collateral requirement

A problem in micro entrepreneur management is that the business is run by one person ("one man show" management). Micro entrepreneur manages his business solely or with his close family. There is no professional management whatsoever. So, if he is sick or having family activities (i.e. wedding, long trip to certain place), he can not run his business because there is no second layer management. If he can not run his business, so he can not pay installment. For example, if he is sick for three days, so he can not pay installment for three days too. Islamic Financial Institution can overcome this condition through flexible installment mechanism. The mechanism is as follows:

* Islamic Financial Institution will provide payment schedule, for example, for 100 days installment
* In financing agreement, customer will pay installment in 100 days or 100 times whichever is earlier.

* It means, customer can pay once installment in a day, or more than once installment a day. For example, the installment is IDR 50.000 daily; customer can pay IDR 50.000 a day or IDR 100.000 a day etc. So, it is possible for customer to pay double or may be triple installment a day, with maximum installment is 100 times.

* In contrary of this, if the customer can not pay installment because he can not run business at certain days, he can

pay installment on another/next day. For example, the customer can not run business for three days because his son/daughter marries. He could pay the three days installment on other day when he is back to run the business again. So Islamic Financial Institution must be flexible in installment mechanism.

The flexibility must be implemented too in collateral requirement. Most of micro entrepreneur doesn't have sufficient "legally ? formally collateral". In this case, Islamic Financial Institution must consider the other form of "collateral", such as member card of ojek5, academic certificate, etc. This "collateral" maybe is not collateral as legal formal basis, but it can be considered as "collateral" in micro sector.

Self insurance

Sometimes insurance company can not cover customer credit-life insurance or fire insurance because, the amount is very retail. A large number of customers and a very small credit amount per customer. If this is the case, the Islamic Financial Institution can organize self insurance. Usually, customer will pay administration fee for financing facility. Islamic Financial Institution can add component of "self insurance cost" in this fee. It will be managed as pool of fund basis. So if there is a customer died so his family get difficulty to pay installment, Islamic financial institution can write off the financing using "self insurance fund". Or in other cases, the customer outlet is fired, the financing can write off using this fund.