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Implementation of ESG Principles in Islamic Fintech: A Case of P2P Alami Sharia

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Abstract

Due to its emphasis on social and environmental effects as well as its connection to increased financial performance, the topic of environmental, social, and governance (ESG) is quite popular globally. Similarly, another idea that is gaining popularity around the world is Islamic financial technology (fintech), which complies with Shariah. As they both address issues with social development, these two ideas have numerous shared ideals and characteristics. However, as ESG is a novel idea, there are many obstacles and difficulties in integrating it into financial institutions. The development of the Islamic fintech industry has advanced to the point where it now takes into account the potential for coexistence with these SDGs and ESG as well as further carving out a chance for improved innovation and financial power. This study uses a descriptive-analytical methodology to examine how ESG principles are applied in Islamic fintech. The information is gathered from a survey of the literature and interviews with prominent Islamic Peer to Peer Financing Alami Sharia and Islamic fintech figures. This paper finds that Fintech Peer-to-Peer Financing Alami Sharia in its operations, especially in distributing financing to beneficiaries, pays attention to and applies ESG principles. This research also finds a unique approach to how Alami Sharia can realize maqashid shariah that is in line with ESG. This study is one of a few research papers in the field of Islamic fintech and its correlation with ESG. This study provides a new and unique paradigm for implementing ESG principles in Islamic finance, especially in Islamic fintech that could be a reference for stakeholders.

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Introduction

Indonesia's economic activities are inseparable from supporting micro, small and medium enterprises (MSMEs). According to the Coordinating Ministry for the Economy of the Republic of Indonesia (2023), it can be seen that the share of SMEs in the gross national product (GDP) was 61.09% on 6 March 2023. So that SMEs can absorb the majority of the workforce, reaching 97% of the total absorption of the national workforce (Yuniken, 2023The large contribution of MSMEs will be more effective if it is balanced with an easy and simple source of capital. In fact, MSME financing is still very low at 20% (Yuniken, 2023). Formal and conventional financial institutions, such as banks, consider MSMEs to be unbankable because they do not meet the requirements. However, along with technological developments, there are many options for channeling funds for MSME financing. This technology-based distribution of funds is known as financial technology.

Fintech according to Buckley and Webster (2016) is a financial product and service that is the result of a combination of technology platforms with innovative business models, for example Peer to Peer Financing or also known as P2P Financing. P2P Financing is a new platform innovation for financial transactions that does not go through intermediaries or financial intermediaries such as banks, but can directly connect recipients of loans/financing with funders (Surbakti, 2022). In Indonesia, P2P Financing has become popular since 2015.

According to the Global Islamic Finance Report 2022, Indonesia has had the fastest increase in fintech growth in Southeast Asia since 2016 when the Financial Services Authority (OJK) first issued Peer to Peer (P2P) fintech regulations. Information technology-based financing and funding services are regulated in the Financial Services Authority Regulation 10/POJK.05/2022. In addition, when viewed globally through the Global Islamic Financial Technology (GIFT) Index, Indonesia is ranked third after Malaysia and Saudi Arabia with a score of 65. Even though it is still relatively new, the growth of P2P Financing in Indonesia is very rapid. Based on OJK data, as of March 2, 2022 there were 102 P2P Financing companies with OJK licenses. A total of 95 conventional P2P fintech companies and 7 Islamic P2P Financing fintech.

Sharia P2P Financing has also been regulated in the Fatwa of the National Sharia Council of the Indonesian Ulema Council Number 117/DSN-MUI/II/2018. DSN MUI explained that sharia-based digital financing services are the provision of services to bring together financing providers and recipients of financing based on sharia principles through an electronic system using the internet network. (DSN MUI Fatwa No. 117/DSN-MUI/II/2018, 2018). With this fatwa, the Muslim population in Indonesia should no longer have doubts about using Sharia P2P Financing as a platform for transactions, both as investors and MSMEs/publishers.

In general, as a new Islamic fintech industry, fintech faces various opportunities and challenges. The opportunity is to increase the awareness of the Indonesian Muslim community to use sharia compliant financial services. On the other hand, Islamic fintech can provide solutions for MSMEs that have difficulty accessing capital services, dynamic regulations, and access to capital for fintech startups (Surbakti, 2022).

These opportunities and challenges must be captured as an initial reference to support the growth and development of fintech in Indonesia. In general, Indonesian Vice President Ma'ruf Amin said that he wanted the government to continue to strengthen the Islamic economy and finance in the country. He said, the government would soon form a special Halal or Sharia department in ministries or institutions (this was conveyed at the virtual opening of the Ijtima' Sanawi DSN-MUI on Thursday 5 September 2020).

In Indonesia, the role of sharia P2P financing is very important for MSME funding, especially to support the government's plans to advance the sharia economy. Ada Alami Sharia is a sharia P2P Financing company that has made positive achievements, namely channeling more than IDR 2.4 trillion in financing (Alami Impact Report, 2021). Alami Sharia in its application uses the principles of Environmental, Social, Governance (ESG). In Indonesia, Alami is the only Sharia P2P Financing that applies ESG principles. Currently ESG does not have a definite standard. Based on the Financial Services Commission of Ontario, it has three factors that can broadly describe its essence, namely the physical environment. The social factors in the ESG discussion can cover every social impact caused by company activities on society, and governance factors in the ESG discussion can cover everything related to company management, in other words how the company is managed (FSCO, 2016).

There are two important roles for ESG in SRI (Sustainable and Responsible Investment), namely as a proxy for sustainable SRI performance and as a market driver. Investment activities that use the application of ESG must pay attention to three aspects. These aspects are as follows: first, the company's core business is not engaged in the business of weapons, pesticides, gambling, nuclear, tobacco, pornography, alcohol, and genetically modified organisms (GMO). Second, the implementation of human resource management must pay attention to human rights. Third, the activities carried out by the company must be of good quality in various aspects such as eleven company governance, community involvement, and fair and ethical business behavior (Syarifuddin, 2022).

According to the OJK Institute, investors consider that the benefits of ESG (environmental, social, and governance) are not very important and have high costs. However, in recent years, there has been a new trend among investors that ESG factors should be taken into account when measuring company performance. Most empirical evidence suggests that "good" issuers have high ESG scores. This shows that ESG is positively correlated with the rate of return on invested capital and the company's rate of return. According to Robert G. Eccles, Ioannis Ioannou, and George Serafeim, the environmental impact assessment of a company has a significant positive effect on company value (Eccles et al., 2012). According to Hassel L.G. ESG/SRI (Sustainable and Responsible Investment) certified companies are better able to achieve higher returns on invested capital (RoE) and continue to grow over time in a sustainable manner (Hassel, 2013).

In previous research, there has been research on corporate social reporting that has been carried out a lot in recent years. The implications of corporate social reporting have also been shown to have a positive correlation with corporate financial performance. ESG literature has provided various views and arguments about the importance of companies complying with ESG rules, taking into account that the application of ESG in companies can have an impact on the company's financial performance in the long term and have a sustainable effect for the company (Hastalona and Sadalia, 2021). Based on Hassel's research, ESG/SRI-certified companies are better able to achieve greater returns on invested capital (RoE) and continue to show sustainable growth over time (Hassel, 2013).

Whereas, on the other hand, there are companies with low ESG scores but good investment returns. The factor associated with this is ethical beliefs. There are several companies with good corporate governance and financial performance in sectors outside of ESG, including tobacco companies. For some groups, for example, ethical investors who adhere to ESG values, they are less likely to approach companies that ignore ESG values (Manescu, 2011).

When viewed from an Islamic financial perspective, some principles are in line with the ESG concept. These principles are found in the Al-Quran as follows; management (Khilafah) (QS AlBaqarah {2}: 30), Trust (QS Al-Ahzab {33}: 72), Balance (Mizan) (QS Al-Qamar {54}: 49), and Ihsan (QS Al -Baqarah {2}: 195). These concepts show the importance of environmental, social, and governance in Islam by enjoining what is good and preventing what is evil (al-amr bi al-ma'ruf wa annahy 'an al-munkar) (QS Ali Imran {3}: 110) (Syarifuddin, 2022).

In general, the ESG concept and Sharia provisions have the same goal of promoting positive values in carrying out business activities. The ESG concept and sharia provisions have some similarities in protecting the environment, socio-economic development, and good governance of the financial industry (Ma'ruf, et al., 2021). Therefore, as a platform based on Sharia financial technology, Alami Sharia implements ESG in its corporate governance. The author aims to analyze the implementation of ESG principles in Islamic Fintech. The author wants to know about the implementation of the Alami Sharia Fintech P2P Financing, especially in the governance of Alami Sharia which pays attention to and implements ESG principles. This research is one of the studies in the field of Sharia fintech and its correlation with Environment, Social, and Governance (ESG) using a qualitative method, namely literature study. This research provides a new and unique paradigm in the application of ESG principles in Islamic finance, especially in Islamic fintech which can be a reference for stakeholders.

Literature Review

Since the modern era, the way humans transact has been more advanced, in the past humans transacted only directly (direct finance) but now it can be done indirectly (indirect finance). The existence of this indirect transaction, of course, requires the help of financial intermediaries. According to Frederic Stanley Mishkin, the transaction process indirectly using the help of financial intermediaries is called financial intermediation or financial intermediation (Mishkin, 2011). The process is when a financial intermediary institution acts as an intermediary and connects those who wish to lend their money to those who need funds.

Financial intermediation is important in financial markets, because of its role in solving the following problems (Mishkin, 2011):

1. Financial intermediation can minimize transaction costs.
2. Financial intermediaries can manage the risks of their investors or customers so that financial intermediaries can share risks (risk sharing) which makes transactions safer because risks can be more controlled.
3. According to Gurley and Shaw (1960), financial intermediation exists to eliminate asymmetric information problems, namely situations where one party knows more about the actual situation than the other party. Asymmetric information is divided into two parts, namely adverse selection, which may occur initially before the transaction, and moral hazard, which may occur after the transaction.

There are several types of financial intermediation (Mishkin, 2011), namely depository institutions, Contractual Saving Institutions, and Investment Intermediaries. The three types of financial intermediation are conventional financial intermediation. Currently, there is a new financial intermediary that uses artificial intelligence to carry out its main function which is currently used in financial technology (fintech).

According to the Financial Stability Board (FSB), fintech is a technology-based financial service innovation that can create new business models, applications, processes, or products that have a significant impact on financial markets and institutions and the delivery of financial services (FSB, 2021). Fintech refers to the use of software and digital platforms as a new innovation tools whose aim is to offer financial services to users in various forms of products and services (Missaiifi & Siryana, 2021). Therefore, fintech is a combination of finance and technology that uses technological innovation in financial transactions and various services and products.

Therefore, before the fintech business model is considered mature by the regulator, regulation, and supervision are usually carried out through a regulatory sandbox, a testing mechanism carried out by regulators to assess the soundness of business processes, business models, financial instruments, and governance. from operators. One of the institutions that offer fintech ratings is the Financial Stability Board (www.fsb.org).

In another definition, Chuen and Teo (2015) argue that fintech refers to financial services or innovative products provided through new technology. Based on these different definitions, Sharia fintech refers to innovative technology-based financial services whose business is based on Sharia principles. Within the Islamic finance sector, fintech ensures Shariah compliance of product and service practices and adherence to social and ethical values. It started with the aim of accelerating financial services to customers so that they can easily reach the services offered by the financial industry.

The dynamics of the Sharia fintech business make its business model continue to grow, therefore stakeholders, especially regulators, are required to be adaptive and accommodative in formulating policies related to this industry. On the other hand, it is hoped that the regulations made will still pay attention to aspects of consumer protection and security. To provide legal certainty and provide a sense of security and protection for the fintech regulatory community in Indonesia, various regulations have been issued which become the legal umbrella for each fintech cluster. In addition, the National Sharia Council-MUI also issued relevant fatwas to ensure Sharia conformity of transactions in Sharia fintech operators, namely the DSN-MUI fatwa No. 117/DSN-MUI/II/2018 concerning Information Technology-Based Financing Services Based on Sharia Principles.

Indonesia with a Muslim majority no. 1 in the world is projected to become the center of Islamic economics and finance, all lines in the Islamic economics and finance industry are being boosted by stakeholders, as well as the Islamic fintech industry which is currently growing rapidly. As of May 2022, 29 Sharia fintechs have been registered with the Financial Services Authority and Bank Indonesia. They are fintech in the Payment, P2P, and Digital Financial Innovation categories. Currently, there is no registered or licensed fintech in the Sharia Securities Crowdfunding category.

One type of financial technology that is currently experiencing an increase is Peer to Peer Financing or P2P Financing. P2P Financing is a new platform innovation for financial transactions that do not go through intermediaries or financial intermediaries such as banks, but can directly connect recipients of loans/financing with lenders (funders) (Cai et.al 2016). Whereas Sharia P2P Financing is classified as Sharia Financial Technology. DSN MUI explained that Sharia-based digital financing services are the provision of services to bring together financing providers and recipients of financing based on Sharia principles through an electronic system using the internet network. (DSN MUI Fatwa No. 117/DSNMUI/II/2018, 2018).

There are Sharia P2P financing companies in Indonesia that apply the principles of Environmental, Social, and Governance (ESG), namely Natural Sharia. ESG measures include all additional measures of a company's performance that do not appear in financial reports, because financial reports do not provide an opportunity for companies to inform management and investors about reputation, quality, brand equity, safety, corporate culture, strategy, and other topics. current existing. the knowledge-based world economy is more important (Bassen & Kovacs, 2008). Allow ESG indicators to reveal more nonfinancial environmental, social, and governance information and be used to assess the ability of corporate governance to mitigate risk (Galbreath, 2013).

ESG which is a current issue with its sustainability character is in line with the characteristics of Islamic finance which includes Islamic productive social finance. This is in line because the characteristics of Islamic finance include justice, empowering all stakeholders, ethical practices, and social responsibility are ideas that are at the core of sustainability efforts and initiatives (Syarifuddin, 2022).

Apart from that, fundamentally, Islamic finance has established several principles to eliminate the roots of problems that might lead to damage to society and the environment. This effort is carried out by prohibiting usury, uncertainty (gharar), and gambling (maysir) which are considered the main sources of damage. This prohibition is intended to avoid unequal distribution and unfair distribution of wealth in the economic system (Syarifuddin, 2022).

Methodology

This study used a qualitative method in the form of a descriptive method and a literature study approach. Qualitative research is research that emphasizes words compared to qualifications in collecting and analyzing data (Bryman and (D Hostalona and Sadalia I, 2021), 2003). The source used in this research is secondary data. The secondary data was obtained from the Alami Impact Report 2021. The references, literature, and other documents in the form of journals, books, and previous research related to the title of the journal discussion, namely fintech, sharia fintech, P2P financing, sharia P2P financing, ESG, and Alami Sharia.

Results and Discussion

Alami Sharia is a Sharia P2P Financing that was officially registered with the Financial Services Authority (OJK) in April 2019 and officially obtained a license in May 2020. Alami Sharia has received various awards, both on a national and international scale. The most prestigious award is the Best Islamic P2P Finance Platform 2020 from the World Islamic Fintech Award as the outstanding Peer to Peer financing platform in implementing Sharia financing principles. In 2022 Alami Sharia has 8601 active funders, 985 recipients of financing, and 2.4T of accumulated financing.

Based on data from the Alami Impact Report 2021, Alama Sharia implements ESG principles in conducting its business. First, from the Natural Environment aspect, create an impact monitoring system to ensure that the company is aware of the environmental risks of its business portfolio. Second, from a Social (Social) Natural aspect, ensure that the company is aware of gender proportionality and non-discriminatory behavior in the workplace. Third, from the Governance aspect, Alam strengthens a good governance framework to keep the organization running with ethical practices and safe & accountable data governance.

ESG covers various issues related to the environment (eg climate change), social responsibility (eg human rights), and good corporate governance or good corporate governance (eg protection of shareholders). ESG is also the main indicator of non-financial performance. The

ESG score of the company's performance report includes the use of natural resources, human rights, the level of corruption, and how the company invests in establishing social relations with the community which will ultimately lead to the company's sustainability (Hastalona and Sadalia, 2021). ESG in its measurement aims to obtain additional dimensions of company performance, which are not explained in accounting data. In addition, the company's financial reports do not provide management and investors with information related to quality, know-how, brand equity, workplace culture, strategy, reputational value, safety, and several other assets that are more significant in a global knowledge-based economy. Thus, the ESG indicator provides a broader explanation of non-financial data about social, environmental, and corporate governance performance and can be used to evaluate the ability of company management and support risk management (Tarmuji, et al., 2016).

The first aspect is the environment, so important is the environment that it makes activists and environmentalists talk about loving the environment and not destroying nature. In Indonesia, environmental protection and management is regulated in Law Number 32 of 2009 (UU PPLH). The regulation is intended to warn all Indonesian people who pollute and/or destroy the environment are obliged to carry out pollution control and recovery. The environmental aspect of Alami Sharia is Green Financing which is included in SDGs point number 13, namely climate action. Green Finance is one of Alami Sharia's efforts to support the concept of green finance. This concept aims to create and distribute financial products and services that encourage environmentally friendly investments and sustainable development. In this case, Alami Sharia participates in issuing capital to support projects or developments that are more environmentally friendly.

Natural Support for green finance (green finance) is also included in its participation in supporting the collective mobilization of funds in USD per year which is targeted at 100 billion USD by 2025. This movement aims to address the needs of developing countries in the context of mitigation actions that have benefits as well as transparency in its implementation and fully operationalize the green climate fund through capitalization of the fund as soon as possible. This is a fairly positive movement in supporting the reduction of greenhouse gas emissions on Earth.

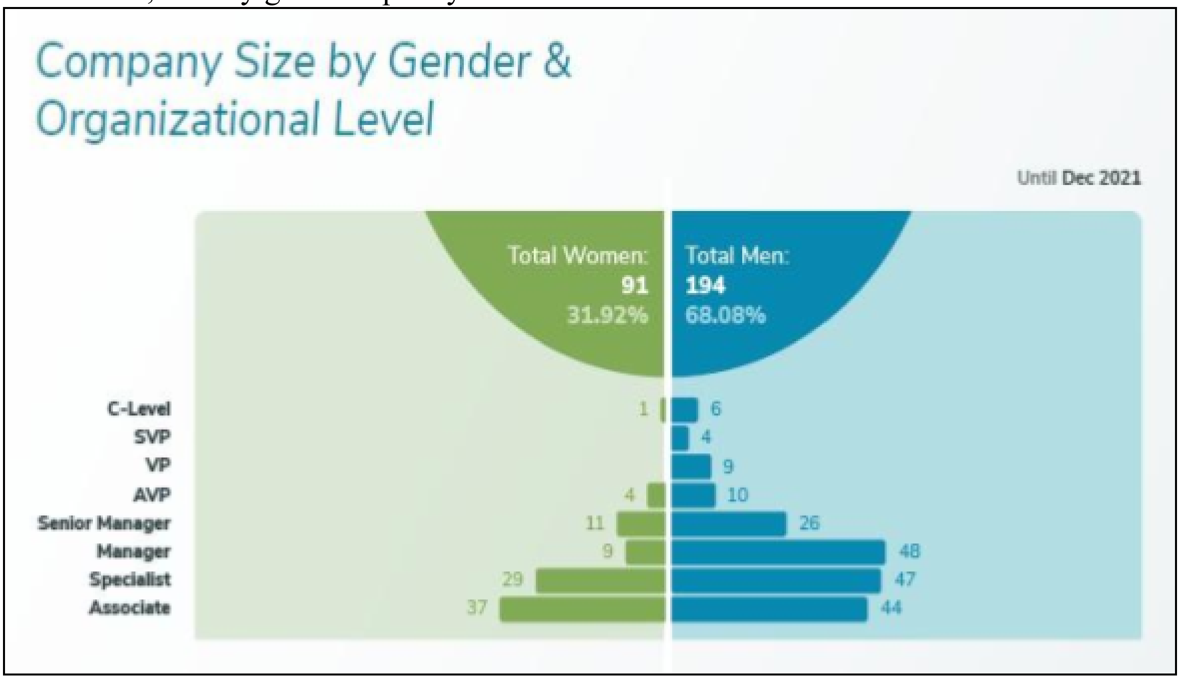
The environmental aspects contained in the ESG are following the Sharia perspective. From a Sharia perspective, preserving the environment must be under the concept of Mizan (balance), namely using the environment responsibly. As Allah SWT has created all creation to maintain balance and harmony. The principle of Sharia investment avoids investing in industries that violate the value system and Islamic provisions in its implementation. Certain types of industries such as alcohol, tobacco, weapons, defense, pornography, and others are not included in the list of Islamic investments (Ma'ruf, et al., 2021). The second aspect of ESG is the social (social) aspect. Alami Sharia is committed and responsible for distributing wealth redistribution through social programs that involve the community and stakeholders, this is in line with SDGs point number 10, namely reducing inequalities. In its implementation, Alami Sharia aims to enable mustahik (people who are entitled to receive zakat) to change their status to muzakki (people who are obliged to pay zakat). Social projects that have been carried out consist of various aspects, for example, education, health, and social.

In an educational project, Alami Sharia provides scholarships to students from various regions in Indonesia who have limited funds due to Covid-19. In a pandemic situation that is completely lacking, of course, there are lots of students who need a helping hand from the muzakki, this has been responded to by Alami Sharia as its responsibility in channeling social funds in the education sector. Please note that education is one of the important pillars in the progress of a country. Therefore, the progress of a country can be seen from the level of education of its citizens. This is closely related to the quality of Human Resources (HR). If a country's human resources have good quality, then there will be many creative and innovative ideas created to solve various problems that exist in Indonesia.

For health projects, Alami Sharia assists in the form of free ambulances for vaccination programs. The Covid-19 pandemic has caused a lot of panic and unrest in society. The ambulance assistance is clear evidence that Alami Sharia cares about the needs of the community at critical and tense times. The government has even made mandatory vaccines to break the chain of Covid-19. The government's goal of requiring vaccines is to reduce pain for sufferers and it is hoped that this will reduce mortality. Even though having a vaccine does not guarantee that someone can be protected 100% from Covid-19, vaccines can reduce the possibility of severe symptoms and complications due to Covid-19.
Ramadan campaign, the meat alms campaign, and the mustahik stall. The Ramadan campaign is the provision of a thousand food packages for breaking the fast which are distributed to Bondowoso, Jember, Situbondo, Bima, Adonara, Makassar, and Palu. The next project is the meat alms campaign which is distributed to 48 families in Banyuwangi, namely in the form of two goats weighing 48 kg. The last social project is the mustahik shop. This mustahik shop uses a qardhul hasan (interest-free loan) contract for 40 mustahik stalls in the country. This indicates that Alami Sharia has contributed to providing capital to MSMEs because MSMEs are one of the pillars of the Indonesian economy today.

The social aspects that have been implemented by Alami Sharia are following Islamic principles. In the Al-Qur'an Fatir verses 29 and 30 regarding the promise of Allah SWT to those who spend in secret and or in open circumstances. In this verse, it promises many things to those who spend money, one of which is a business that is impossible to lose. Prophet Muhammad SAW swore in the name of Allah that wealth will not be reduced because of charity. So when you donate wealth to goodness under Sharia, it is unlikely that the infaq will lead to losses. Furthermore, Allah has also promised to complete the reward for their actions. God also promises His gifts (can be in the form of happiness, honor, glory, and so on).

The third aspect of ESG is governance. The implementation of this concept is about ESG related to gender and the mustahik empowerment program. The program is related to SDGs number five, namely gender equality.



Source: Alami Impact Report 2021.

Based on the information above, it can be seen that there is gender equality in Alami Syariah. This is shown by the proportion of women in administrative positions. Alami Syariah guarantees full and effective participation and equal opportunities for women to take leadership positions at all levels of decision-making. Alami also promotes the use of enabling technology, especially information and communication technology, to empower women. In addition, Alami also supports reforms aimed at giving women equal rights concerning financial resources and the ownership and management of land and other forms of property, financial services, inheritance, and natural resources following national legislation (TBP Indicator Method summary /SDGs, 2017).

Gender in the Sharia perspective prioritizes fairness of rights between men and women. Fair does not mean equal, for example in the aspect of governance in Alami Sharia which shows the presence of women in managerial positions. Both men and women have the same opportunity to excel, this is by the word of Allah SWT in the Al-Quran letter An-Nahl verse 97. The Al-Quran explicitly and straightforwardly pays attention to gender justice, in the sense of denying any attempts at the injustice of gender, especially stereotypes against women. It is strictly warned in the letter Al-Hujarat verse 12. This is because both men and women have the same position before Allah SWT, as abid and caliph what distinguishes them is their charity and deeds.

Conclusion

Alami Sharia, which is a Sharia fintech P2P Financing in Indonesia, applies ESG principles in its business activities. First, in the environmental aspect of Alami Sharia, Green Financing is included in SDGs point number 13, namely climate action. Alami's support for green finance also includes his participation in supporting the collective mobilization of funds in USD per year which is targeted at 100 billion USD by 2025. From a Sharia perspective, preserving the environment must be following the concept of mizan (balance), namely using the environment responsibly.

Second, from the Social (Social) Natural aspect, commitment and responsibility in channeling the redistribution of wealth through social programs that involve the community and stakeholders is in line with SDGs point number 10, namely reduce inequalities (reduce inequality). In its implementation, Alami Sharia aims to enable mustahik (people who are entitled to receive zakat) to change their status to muzakki (people who are obliged to pay zakat). The social aspects that have been implemented by Alami Sharia are following Islamic principles. In the Al-Qur'an Fatir verses 29 and 30 regarding the promise of Allah SWT to someone who spends in secret and or in open circumstances. In this verse, it promises many things to someone who spends money, for example, trade (buying and selling) that is impossible to lose.

Third, from the governance aspect. The implementation of this concept is about ESG related to gender and the mustahik empowerment program. The program is related to SDG number five, namely gender equality. This is evidenced by the proportion of women occupying managerial positions. In the perspective of sharia, both men and women have the same opportunity to excel, this is conveyed in the word of Allah SWT, namely in the Al-Quran letter An-Nahl verse

97. Maintaining human social order and achieving the welfare of mankind through economic support is one of the main goals of Sharia. An in-depth discussion of the Al-Quran and Hadith which are closely related to property and wealth provides evidence that wealth has an important status according to sharia (Ibn'Ashur, 2006). Thus, the ESG concept is in line with the maqasid shariah concept, namely protection of the soul (health), protection of the mind (mind/education), protection of the soul (health), protection of ancestry, and protection of property.

Thus, to manage a company well, ESG information is very important (Syarifuddin, 2022). A company's strong ESG performance can have an impact on a company's knowledge of its long-term strategic issues. This is what helps managers to be able to manage the company with long-term goals. Thus, companies can make long-term decisions to ensure the success of the business they are doing for a longer time so that it remains sustainable (Tarmuji, et al., 2016). The ESG concept aims to bring the financial industry to a higher level, namely "exceeding profits", meaning that the financial industry not only looks at the profitability of the activities it carries out, but companies also need to consider environmental and social aspects at the same time (Ma'ruf, et al.., 2021).

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