
Integrating Sustainability into the Strategic Management of Financial Institutions in Developing Economies

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ABSTRACT

This study discusses the role of financial institution management in supporting sustainable development and strengthening the national economy. In the context of globalization and dynamic economic challenges, financial institutions have a strategic role in channeling responsible financing, managing risks effectively, and encouraging sustainability-oriented investment. This study examines how policies, product innovations, and governance implemented by financial institutions can create positive social, economic, and environmental impacts. Through a qualitative approach with literature studies and secondary data analysis, this study found that the integration of Environmental, Social, and Governance (ESG) principles in financial management can encourage inclusive and sustainable economic growth. The results of this study are expected to be a reference for policymakers and financial industry players in designing strategies that balance profitability and sustainability.

Keywords: Financial Institution, Sustainable Development, National Economy

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INTRODUCTION

Financial institutions play an important role in the modern economic system, both on a national and global scale. As intermediaries between parties with surplus funds and parties in need of financing, financial institutions function not only as capital providers but also as risk managers, drivers of innovation, and implementers of monetary and fiscal policies through financial instruments. In this context, financial institution management is a crucial aspect that determines the stability, efficiency, and contribution of the financial sector to sustainable economic development. Financial institution management covers various aspects, from asset and liability management, risk management, and regulatory compliance, to the development of innovative financial products and services (Janicka, 2016).

In facing global challenges such as the financial crisis, climate change, digitalization, and social inequality, financial institutions are required to develop adaptive and responsible management systems. Therefore, a deep understanding of the principles and practices of financial institution management is very important for policymakers, academics, and industry practitioners. Financial institution management encompasses the strategies, practices, and principles that govern the operations of financial entities such as banks, investment firms, and insurance companies. As critical intermediaries in the economy, these institutions manage the flow of capital, assess risk, and ensure compliance with regulatory requirements. The effective management of financial institutions is crucial not only for maintaining operational efficiency but also for achieving broader economic stability (Sarangi et al., 2018).

Financial institutions are the backbone of a country's economic system. Through financial intermediation activities, these institutions play a role in collecting funds from the public and channeling them back in the form of credit or investment to productive sectors. Therefore, the effectiveness and efficiency of financial institution management have a direct impact on economic stability, business growth, and the welfare of the wider community. Financial institution management is a decision-making and control process that includes financial planning, risk management, regulatory compliance, and the use of technology and innovation in providing financial services. In the era of digital disruption and increasing demands for social and environmental responsibility, financial institution management must be able to adapt, not only to maintain profitability but also to support inclusive and sustainable economic development. By understanding the practices and challenges in financial institution management, we can evaluate the extent of the role of the financial sector in supporting the national development agenda and achieving sustainable development goals (Elobeid E Dirar, 2012).

Sustainable development has become an increasingly important global issue in recent decades. This concept emphasizes the importance of maintaining a balance between economic growth, environmental conservation, and social justice in order to meet the needs of the present generation without sacrificing the capabilities of future generations. Amid challenges such as climate change, energy crisis, social inequality, and environmental degradation, sustainable development is a strategic approach that must be adopted by all countries, including Indonesia. Indonesia, as a developing country, faces major challenges in realizing sustainable development. On the one hand, the need for economic growth and infrastructure development is very urgent, but on the other hand, uncontrolled exploitation of natural resources and increasing greenhouse gas emissions threaten long-term sustainability (Liu & Huang, 2022). Therefore, real efforts are needed to improve the quality and effectiveness of sustainable development through the integration of cross-sector policies, active community participation, and support from financial institutions and the private sector. Efforts to improve sustainable development do not only rely on government policies, but also require collaboration from various parties, including the business world, educational institutions, and civil society. Integration of Environmental, Social, and Governance (ESG) principles, utilization of green technology, and environmentally friendly funding are important elements in strengthening the sustainable development agenda. Thus, it is important to understand the various strategies, challenges, and opportunities in enhancing sustainable

development in order to create inclusive economic growth, strengthen environmental resilience, and improve the quality of life of society as a whole (Park & Kim, 2020).

Sustainable development is a development approach that prioritizes a balance between economic, social, and environmental aspects. In a global context marked by the climate crisis, social inequality, and massive exploitation of natural resources, this concept is becoming increasingly relevant as the main foundation in designing a just and sustainable future. Indonesia, as a country with rich natural resources and a large population, has great challenges and opportunities in realizing sustainable development. Although economic growth continues to increase, disparities between regions, environmental damage, and low quality of life in some communities are still problems that must be addressed immediately. Therefore, efforts to improve sustainable development need to be focused on holistic policies, long-term orientation, and actively involving all stakeholders. Improving sustainable development is not just rhetoric, but an urgent need. Integration of sustainability values in national development planning, strengthening institutions, and innovation in green financing and environmentally friendly technologies are the main keys to ensuring development that is not only fast but also responsible and inclusive. Through this study, it is hoped that a deeper understanding will be created regarding the urgency of sustainable development, as well as various approaches that can be applied to strengthen its implementation at the local, national, and global levels (Versal & Sholoiko, 2022).

The national economy is the main foundation in determining the direction of a country's development. Sustainable economic stability and growth are the benchmarks for a government's success in improving the welfare of its people. In the context of Indonesia, economic development has experienced various dynamics, starting from the recovery period after the economic crisis, the COVID-19 pandemic, to facing global challenges such as geopolitical uncertainty, inflation, and climate change.

As a developing country with abundant natural resource potential and a large demographic bonus, Indonesia has a great opportunity to strengthen its economic structure. However, challenges such as inequality in income distribution, low productivity of the agricultural and industrial sectors, and dependence on raw commodities are still obstacles to realizing a resilient and competitive economy (Zheng et al., 2021). To that end, strengthening the national economy must be directed at diversifying the economic sector, increasing investment, developing infrastructure, digital transformation, and strengthening human resources. The government, together with the private sector, financial institutions, and the community, must work together to create an inclusive, resilient, and sustainable economic system. A study of the national economy is important for understanding the current structure of the Indonesian economy, evaluating policies that have been implemented, and formulating strategies to accelerate economic growth and increase the nation's competitiveness at the global level (Kaftan et al., 2023).

LITERATURE REVIEW

Sustainable Development in the Era of National Economic Recovery

Even though the COVID-19 pandemic was still going on in the middle of 2020 and the economic conditions were in a state of shock, President Jokowi stated that Indonesia must be ready to enter a new chapter, namely a new era of adaptation. Conditions of concern since the crisis in 1998, according to Sparrow et al. (2020), may be in 2020, to be precise, in the second quarter, GDP will show a drastic decline to minus 5.3% (see Graphs 2a & 2b). Coupled with the increase in cases of contamination by COVID-19 until October, it was increasing compared to neighboring countries.

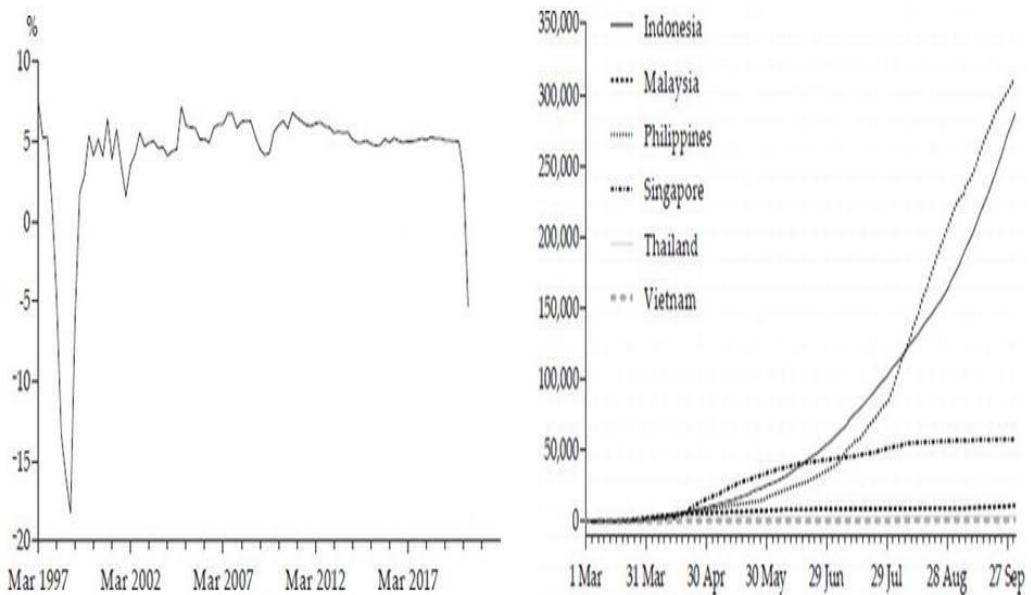


Figure 1. Development of PDB

Source: Sparrow, 2020

Figure 1 shows that the condition of GDP is declining, and cases of COVID-19 infection are the highest in the Southeast Asia region. However, the government immediately proposed a national economic recovery package (PEN) program, which aims to facilitate consumption, overcome poverty, and joblessness, which have declined drastically. Stated quarterly (YoY) GDP growth from 2019 to 2020, categorised by sector and expenditure. The sectors most affected were transportation and storage, which were down by over 30% in June 2020 YoY, and accommodation and restaurants, which were down by 22%. The business services sector, manufacturing, and the wholesale and retail trades were also affected, although to a lesser extent. The reduction in the transport and storage sector is not surprising given that direct transport has been disrupted due to reduced travel from people working from home, and reduced overall mobility due to social distancing and large-scale travel restrictions (Badan Pusat Statistik, 2020).

Sub-sectors experienced contraction, and railway transportation experienced the biggest falls (80 % and 64 % each), followed by storage, and transportation help services. Despite the transportation industry contributing it's less than 4.0% of the total GDP, it accounted for the biggest contribution of all sectors to the 5.3% decline in GDP is a quarter of that. Indonesia's response package, as a percentage of GDP (Hasbi, 2022). It is far smaller than the packages of many wealthy nations. For instance, Japan has allocated 21 % of its GDP in response, while the United States has allocated 12 % and Australia has allocated 10 %. In this area, the Indonesian reaction is insignificant compared to Thailand (9.6 % of GDP); however, it is comparable to Vietnam (3.6 %) and the Philippines' (3.9 %) responses. It is essential to be cautious when comparing the extent of financial stimulus packages among different countries. As Covid-19 infection rates, limitations on social mobility, and their impact on the economy vary widely (Dzigbede & Pathak, 2020). The contrasting proportion of rich and poor nations is evident and can be partly explained by the contrast in borrowing abilities and mobilization of resources within their boundaries. Indonesia's taxable population is comparatively limited, and the country's yearly income from taxes is approximately 12% of the Gross Domestic Product (GDP), which is estimated to decrease to less than 10% in the current year.

In the economic recovery package, it is seen that the largest component is social protection, worth nearly Rp204 trillion, to encourage consumption and reduce the impact of poverty, because of the economic decline. The PEN program aims to support the private sector by providing business incentives worth IDR 124 trillion through tax deductions and IDR

54tn for corporate financing. The government has assigned IDR 121tn to support micro, small, and medium enterprises (MSMEs), primarily providing assured working capital and interest rate subsidies. A poll conducted by Munifatussa & Saleh (2020), in August, discovered that sectoral and regional governments had an IDR 106tn budget, of which IDR 18tn was set aside for job creation and public works projects. The main methods of distributing social protection packages include existing initiatives like the Family Hope Program (PKH), food assistance programs such as Staple Food Cards and Basic Food Social Assistance, and the Village Cash Assistance program (BLT). Additionally, the government launched a new Pre-Employment Card and allows discounts on electricity bills. Although the collection of software is comprehensive, the packages were created. To reduce poverty in times before Covid-19, not during the pandemic. Most programs are focused on helping impoverished communities and rural areas, rather than middle-class and urban households that have been impacted by the COVID-19 pandemic. Moreover, the system for identifying the target beneficiaries is based on a database of social welfare information (DTKS), which has been created over the past decade (Maulana & Mawadah, 2023).

The database has been useful in enhancing the identification of social protection program beneficiaries. However, it is unable to cope with significant disturbances and the resulting poverty trends. Specifically, it cannot recognise temporary alterations in households' well-being caused by individual events, for example, unexpected loss of employment or serious health issues, as well as changes in financial circumstances are common. Moreover, the database has not been updated since 2015. According to a 2020 survey conducted by the World Bank, COVID-19 has caused several families with lower-middle incomes may face sudden reductions in household income, particularly as 24% of breadwinners have lost their jobs. Java experienced most job losses, notably in urban zones, among people with upper secondary education or less, and in the industrial and services sectors. Nearly two-thirds (around 64%) of employed people suffer a drop in earnings (Kaftan et al., 2023).

Government aid is a crucial measure to cushion the impact of reduced food and non-food spending, according to 55% of survey participants. Social protection program databases struggle to keep up with swift changes in welfare status, causing more errors in excluding the intended beneficiaries (Hidayatullah et al., 2020). has identified a pressing need to improve the flexibility of the social protection targeting system. For example, this could involve introducing an innovative information system. This could include the use of social registers that cover 60% of the poorest population, social assistance programmes that can be implemented upon request (as in the case of the Pre-Employment Card programme), or community-based targeting (Rahmayati, 2021). Sectoral programs and local governments have received the largest share in the 2021 package, unlike the 2020 PEN program. Economic recovery plans focused on tourism, ICT, and industrial estates have received a total of IDR 137 trillion in funds. To provide social support, Rp 110 trillion has been allotted for financial aid programs based on conditions, basic food support, pre-employment programmes, funding for rural areas, and non-restricted financial aid. Business incentives amounting to IDR 20 trillion, IDR 15 trillion to finance corporations, and IDR 49 trillion for small and medium enterprises will be allocated to the private sector. The effect of the COVID-19 outbreak on the economy was severe, forcing the government to adopt a more serious approach in managing it (Hasbi, 2022).

Noted that the issues that occur from different PEN initiatives designed for MSMEs are sometimes unsuitable for their needs. In July 2020, a survey conducted by the Central Statistics Agency (BPS) out of twenty-five thousand three hundred micro and small businesses, also known as UMKs, and six thousand eight hundred medium-large businesses (UMK) showed contrasting assistance necessities for both types of enterprises. During the pandemic, 70% of MSEs identified that government support for working capital is a priority, while 40% of SMEs highlighted the need for electricity subsidies, relaxed loan payments, and delayed tax payments. Both UMK and UMK requested a provisional electricity subsidy, which is currently unavailable (Syed et al., 2020). It should be borne in mind that giving electricity discounts using PEN resources may lessen the financial load on companies faced with a crisis and streamline administrative procedures since the State Electricity Company (PLN) owns the

current database. One of the major issues when implementing the PEN package is the minimal disbursement rate. Up to the 7th of October, only 48% of the designated budget had been paid out. The disbursements accelerated in the month of September, especially for social protection initiatives and support schemes for micro, small, and medium-sized businesses, reaching rates of 78% and 73%, respectively. Yet, rates are much lower for the remaining components: The health package has a rate of 30%, sectoral and local government support has a rate of 26%, and business incentives have a rate of 24%. No funds, however, have been awarded for corporate financing (Barbier, 2020).

METHOD

This study used a qualitative approach with inductive-descriptive analysis and content analysis, in which data were collected from literature studies sourced from both Sinta Dikti-indexed and reputable international journals, such as Elsevier, MDPI, WoS, Springer, and others. The information in this article focuses on statistics acquired from BPS and/or survey research reports regarding the contribution of Islamic Banks to the National Economic Recovery (PEN) during the New Normal Covid-19 period.. Adaptation era in Indonesia, as secondary data, so that it can be shown what the role of national sharia banking is in its participation in restoring the economy in the financial institution sector.

RESULT AND ANALYSIS

Sustainable Development in the National Economic Recovery Era

The COVID-19 pandemic has affected nearly every country in the world, including Southeast Asia, which, of course, has had an impact on the economic sector. Sharia banking institutions, especially as an important pillar in a country's economy, especially in stabilizing the monetary aspect and supporting the economy through the function of creating liquidity and transforming risk (Sodikin, 2020). The role of Sharia banks in increasing economic growth in a country is very clear. For example, countries that are members of the GCC, such as Bahrain, UAE, Kuwait, Oman, Qatar, and Saudi Arabia, in a survey noted that there is a relationship and impact on banking development between Islamic banks and economic growth. Where banking can encourage growth through supply-leading financial intermediaries is very important for growth (Nurul et al., 2023). The role of banking and economic growth is intertwined, even though it is still dominated by conventional banks (Rousseau and Wachtel, 1998). Meanwhile, during the Covid-19 pandemic, statistical data shows that size, liquidity, capital adequacy, credit risk, and cost management have had for years now, there has been a significant and optimistic connection between Islamic banks and economic growth, especially after the global financial crisis.

The Sharia financial system has been affected by the COVID-19 pandemic, and specifically Islamic banking, another opportunity to showcase its resilience, increase its assets, offer social financial services, and prove itself as a genuine rival to the traditional financial system. (Rabbani et al., 2021; Hasan et al., 2021; Hasan et al., 2020; Rabbani et al., 2021). It is argued that Islamic finance will play a vital role as an open social innovation in the financial system after COVID-19 (refer to Figure 2). Islamic banking institutions' hidden strengths have been revealed by the COVID-19 pandemic (Hassan et al., 2020). According to Cuadro-sáez et al. (2020) stressed the need for a new way of thinking in the money and financial system of the world to tackle the current crisis. Sharia finance uses transactions without interest, which makes it an ideal solution for avoiding crises like the financial crisis and COVID-19 in an Islamic economy. The advantage of Islamic banking, besides being a profit institution, is that it is also an Islamic social financial institution that has financial tools and services suitable for situations like this, for example, there's Zaka, Qardh-Hasan, Endowments, Sharia microfinance, and takāful ta'awuni. Government fiscal and monetary policies, like initiatives aimed at helping the poor, can also help the vulnerable sections of

society. And, after the global vaccination against the COVID-19 pandemic, many countries began to move quickly for economic recovery, including Islamic financial institutions, in this case, Islamic banks, which took part in responding to this. Islamic banks are starting to shift from 'response' mode to 'recovery' mode, moreover supported by FinTech to take advantage of their unique assets and skills to take advantage of this opportunity (Nour Aldeen et al., 2022).

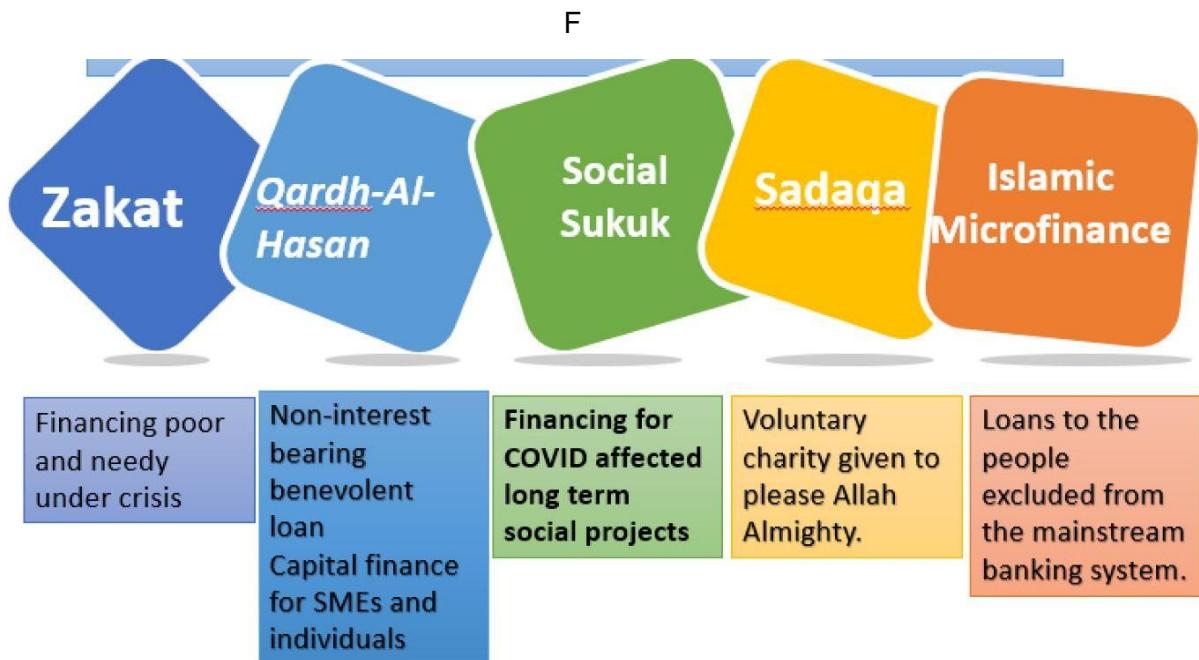


Figure 2. The COVID-19 and Sharia Social Finance

Source: Rabbani et al., (2021)

According to Syamsuri & Wibisono (2019) what is meant by short term, short term and long term defined as a period of less than one year, medium term is defined as a period of one year to five years, and more than five years is classified as long term. In Indonesia itself, in the context of national economic recovery, especially recovery in the monetary sector, that Bank Indonesia as the institutional parent of Islamic banks must look at the maintenance of macroeconomic stability, particularly in the financial sector to ensure that there is an adequate amount of money available in the economy and ensure smooth trade transactions without causing inflation. Various indicators are typically adopted to evaluate monetary policies, such as the money supply, inflation, interest rates, exchange rates, and public opinions. Highlighted that the interest rate can affect investment in the industrial sector, which drives production, while the exchange rate can impact product prices and production inputs. The interest rate and exchange rate are financial tools that impact the trade of industrial goods. The government can follow an expansionary monetary policy by increasing the money supply, and can follow a contractionary monetary policy by reducing it. States that, besides having to maintain monetary stability, banks must also exercise financial control by using expansionary and contractionary fiscal policies. Expansionary fiscal policies can boost national income and reduce unemployment rates. In contrast, contractionary fiscal policies reduce inflation and decrease the foreign balance of payments deficit (Lestari & Ridho, 2018).

Sharia banks, particularly those that have social tools like zakat, infaq, and endowments, could aid the government and the economy in recovering from the crisis. According to Mabrukah (2024), Islamic banks can help more in carrying out their functions for national recovery such. This initiative aims to save lives through medical aid funded by zakat-infaq and endowment waqf schemes. It also intends to create safety nets and programs to uplift struggling households, mainly through zakat infaq, and boost business actors, particularly

micro and small-sized enterprises. The initiative offers financial and business support, such as digital marketing tools funded by zakat-infaq-waqf schemes. Lastly, the initiative looks to save small microfinance institutions by establishing cash waqf and adopting financial technology and IICSF, primarily in Sharia financial institutions that target MSEs. On the other hand, Islamic banks during the new normal adaptation to the COVID-19 pandemic must mitigate risks earlier by strengthening liquidation, restructuring, and changing strategic initiatives. One of them for state-owned banks is the merger of several Islamic banks into one bank so that they are effective in helping to handle liquidity due to the COVID-19 pandemic outbreak, so as not to cause big losses for both the community and the nation (Mahardika & Tanweer, 2025).

Impact Bank Involvement in Sustainable Development in the Era of National Economic Recovery in Indonesia

The national economic recovery package, or PEN, after the announcement of a new era of adaptation due to the impact of Covid-19, which has devastated all aspects of life, including

the economic sector since April 2020, requires the support of various parties and the collaboration of all components of society. When referring to BI policies related to monetary stability, Islamic banks have the opportunity to be involved in this matter. Moreover, the Islamic economy, with the involvement of Islamic finance, in which Islamic Banks give priority to the real sector, including small and medium-sized enterprises (SMEs), and use Islamic economic institutions to support and drive growth in this sector. Islamic finance has captured a market share of 8.5%, and it is expected to keep expanding and developing. The COVID-19 outbreak has resulted in a decline in economic activity, particularly in the SME sector. The COVID-19 pandemic has had a significant impact on SMEs. Islamic economic institutions, including Islamic banks, can play a crucial role in reviving SME economic activities (Hermanto, 2018).

Islamic banks play a crucial role in national economic recovery. Islamic financing recorded an impressive growth of 349.34 percent in income. Islamic Micro Finance Institutions (LKMS) witnessed a growth in financing increased by 11.75 percent, whereas Sharia Peer-to-Peer (P2P) lending institutions saw a small decline in assets of 0.05 percent. Social institutions observed an increase in collecting social funds at the Indonesian Zakat Initiative (IZI) by 48.08 percent, and the distribution of social funds by the National Amil Zakat Agency (BAZNAS) has seen a significant increase of 114.27 (Widarjono et al., 2020). The Sharia finance institutions are vital in the recovery of the real Micro, Small, and Medium Enterprises (MSME) sector amid

the COVID-19 pandemic. Their efforts involve enhancing MSMEs' financial strategies, assisting financial customers, offering relief to affected customers, participating in online marketing for customer products, maximising profit sharing, reinforcing partnerships, and dispersing social capital for SME economic activities. The Sharia banks in Indonesia stand side by side with their conventional counterparts in the dual banking system, in addition to Bank Syariah Indonesia (result of the merger of BSM, BNI Syariah and BRI Syariah) together with the central bank aiming to achieve price stability in the economy by using conventional and sharia monetary instruments in a dual monetary system. In terms of performance, the cointegration relationship between the output and inflation models is examined. Long-term convergence can be achieved to correct deviations in output and inflation through Islamic bank deposits and financing. However, the short-term effect is only contributed by Islamic bank deposits on output. Islamic bank deposits do not contribute in the short term to inflation. Islamic bank financing does not have a short-term relationship with output and inflation. As a result, there has been a decrease in the effectiveness of the contribution of Islamic bank financing to the economy (Ur Rehman et al., 2021).

Sharia banks in Indonesia, similar to traditional banks, though with variation, also experience bad financing problems, which directly have a significant impact on the banking system, the level of soundness of banks, and the national economy. However, overall, especially BUMIN's sharia banks, can manage these issues appropriately to reduce risks and ensure the progression of the sharia banking system. Managing problem financing is highly significant, not only to complement the settlement of a firm's outstanding debts and receivables, but is also closely linked to the sustainability of the sharia banking industry as it

significantly helps grow the Islamic economy (Zainol & Kassim, 2010). Islamic banks, which are the core of the Islamic financial system, play a role in encouraging entrepreneurship. This institution is expected to be at the forefront of serving the needs of the MSME sector and helping them from all kinds of financial constraints. Especially in the era of national economic recovery, the role of Indonesian Islamic banking is in serving the needs of MSMEs and various issues and challenges in achieving MSME financial inclusion. Islamic banks, which have a dual role as profit institutions as well as social financial institutions, should also have a dual role, such as distributing zakat for socio-economic welfare in increasing economic growth and purchasing power of the Indonesian people and reducing the poverty rate that was implemented during the 2002-2019 period in Indonesia. Moreover, zakat, which has been proven to contribute to reducing poverty before the Covid-19 pandemic, can be used as a model for national economic recovery in Indonesia after Covid-19 (Ascarya, 2022).

Encouraging programs that employ Islamic financial tools, such as Sharia banks and other Sharia financial institutions, have the potential to rebuild the economic surplus and expedite the process of economic recovery. This will help reduce poverty and facilitate the attainment of income equality. Wealth (Wusqo et al., 2022). The social and economic impacts of the COVID-19 pandemic have significantly affected the overall well-being of communities. To help reduce poverty during the pandemic, the government has introduced several schemes, including increasing the involvement of Sharia or Sharia economics. Indonesia's economy can derive significant strategic advantages from the contribution of the Islamic economy both now and in the future. People believe that empowering the sharia economy, including sharia banks, is necessary for national economic recovery. This is because the community perceives supporting the Islamic economy in Indonesia as their response, thus it is significant for Islamic economic institutions and including banks.

CONCLUSION

Based on the discussion that has been conducted, it can be concluded that the management of financial institutions has a strategic role in supporting sustainable development and strengthening the national economy. Through the application of good governance principles, effective risk management, and the integration of sustainability values in financial policies and products, financial institutions can be a catalyst in driving inclusive, environmentally friendly, and sustainable economic growth. Efforts such as the distribution of green financing, ESG (Environmental, Social, and Governance)-based investments, and the empowerment of productive sectors such as MSMEs show that financial institutions are not only profit-oriented but also have social and environmental responsibilities. In addition, synergy between the government, financial sector, and society is key to creating a national economic system that is resilient and responsive to global challenges. With adaptive and visionary management, financial institutions can be the driving force of economic transformation towards a more sustainable and highly competitive direction. Therefore, strengthening managerial capacity, financial innovation, and commitment to the principles of sustainability need to be continuously improved in order to realize sustainable and equitable national development.

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