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# Islamic Financial Institutions' Role in Applying 5C+1S Principles for Sharia-Compliant Financing Decision-Making Practices

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**Abstract**
**Purpose:** This study analyzes the implementation of the 5C+1S Principles in Islamic Financial Institutions, focusing on its effectiveness in providing financing.
**Methods:** This study used a descriptive research method. Data collection techniques included literature review and triangulation, utilizing various data sources to ensure comprehensive analysis.
**Results:** The findings highlight several key points for each of the 5C+1S Principles. The Character principle emphasizes the importance of debtor discipline. The Capacity principle focuses on whether the customer owns a business, while capital concerns the amount of funds used by the debtor in their business. Collateral is the guarantee provided by the debtor, and the Condition of Economy evaluates the debtor's ability to handle future economic situations. The Sharia principle ensures that the customer's business does not violate Islamic law and complies with the fatwa of the DSN.
**Conclusions:** This study confirms that implementing the 5C+1S Principles is beneficial for Islamic Financial Institutions in ensuring responsible financing and minimizing the risk of bad debt.
**Limitations:** The researcher acknowledges certain limitations of this study, particularly regarding the depth of analysis, as this study only briefly explores the 5C+1S principles in the context of financing.
**Contributions:** The authors hope that this study will be useful and provide insights.

**Keywords:** *Islamic Financial Institutions, Implementation of 5C+1S Principles, Provision of Financing*

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## 1. Introduction

Every Islamic Financial Institution, whether a bank or a non-bank, must align with and adhere to Sharia principles in its operations. According to Indonesian Law No. 21 of 2008 on Islamic Banking, these Sharia principles are based on Islamic law in banking activities, according to the fatwas issued by the institution authorized to determine fatwas in the Sharia field. The application of Sharia principles must also refer to Islamic business ethics, which are based on the Qur'an and Sunnah. We can also observe the current development of financial institutions, where the rapid growth of Sharia-based financial institutions is widely discussed, with many conventional financial institutions opening Sharia units. Financing is an urgent product in the banking system to assess the success of an institution, such as an Islamic Financial Institution, that provides financial services. In principle, credit and financing are the same (Fakhrunnas & Anto, 2024).

According to Achsani and Kassim (2021), the banking system in Indonesia consists of two systems: Islamic and conventional banks. In the banking world, it is impossible for all credits to be distributed smoothly. There will always be some customers who default on payments. Islamic banks and non-bank Islamic Financial Institutions are financial institutions that use Sharia principles in their operations. This is due to competition, where there is continuous performance improvement in Islamic Financial Institutions to expand and develop their market reach. From the development timeline, the existence of these institutions has managed to survive and even increase their market share, which will be observed over time. The reverse can also be observed (Rahmah et al., 2025).

Many studies have been conducted on this topic. However, the author cannot cite all of them individually. From several of these studies, Islamic Financial Institutions have differences in deciding installment payments to customers, including research conducted by Abdeljawad et al. (2024), who only used the aspects of Capacity and Condition of Economy as supporting factors to strengthen the data of potential customers. This is almost the same as the research conducted by Ph.D and Abacha (2023), which found that in practice, only 3C and 1S were used, namely Character, Capacity, Collateral, and Sharia. Meanwhile, the research conducted by Rahmasari, Cahyandito, and Tato (2022) found that in determining the distribution of financing, 5C was used, even using the 7P concept (Personality, Party, Prospect, Payment, Profitability, Protection).

Fahamsyah, Laila, Rakhmat, and Shabbir (2023), "Credit Risk Management Pertaining to Profit and Loss Sharing Instruments in Islamic Banking," explains the difference for Profit and Loss Sharing instruments in Islamic Banking. In the Risk Management approach to installments, it is not sufficient in the context of partnership agreements like mudharabah and musyarakah, as it is necessary to consider their special aspects because they use Profit and Loss Sharing instruments. For this reason, several things need to be specifically identified, such as the contract rules where the financial institution requires detailed information about the type of project to be financed and accounting arrangements to avoid the mudharib from manipulating the initial agreement through transparency and financial openness.

Penn and Jude (2024) in their research found that 4 Swedish banks in distributing loans prioritize the principle of consultation and minimize the use of personal intuition in decision-making. However, it cannot be denied that financial institutions usually prepare the deals they want to achieve, with their limitations. If the customer does not meet these limitations, the installment agreement will be canceled. Mahera, Ilham, and Albahi (2025) found that non-bank Islamic Financial Institutions in providing financing apply principles through profit-sharing contracts. This is expected to be the ideal solution for empowering micro-enterprises, in which empowerment means providing authority and capacity to develop themselves to become more capable.

This shows that there has been an improvement in services, especially in managing the risk of bad debts. This decline is not easy, especially in just one year. The level of loans facing repayment difficulties in Islamic Financial Institutions could have decreased due to the application of the 5C+1S Principles (Character, Capital, Capacity, Collateral, Condition of Economy, and Sharia). The 5C+1S Principles are indeed good for checking the sustainability of the financing provided. This curiosity has driven the author to analyze the key points taken from the 5C+1S Concept (Character, Capital, Capacity, Collateral, Condition of Economy, and Sharia).

## 2. Literature Review

Islamic Financial Institutions have existed and developed rapidly. There are now many types of Islamic Financial Institutions throughout Indonesia, including Islamic Banks and non-banks. An Islamic Financial Institution operates based on Sharia principles. Islamic Financial Institutions, which are based on Sharia principles, serve as an option and solution for Muslims who want to avoid interest-based financial institutions. However, they have also become a choice for both Muslims and non-Muslims (Benamraoui, Moussa, & Hussien Alsohagy, 2023). Islamic Financial Institutions must be responsible, according to Sharia, to ensure that their practices not only avoid riba (usury) but also are free from elements of maysir (gambling), gharar (uncertainty), and other prohibitions that are not permitted by Islamic law.

Islam commands the avoidance of things like maysir, gharar, and other prohibitions, as these are considered acts of injustice. The organizers of Islamic Financial Institutions should not only focus on the vision of maximizing profits by neglecting Sharia, but should also have a Sharia vision. The process of ensuring that an Islamic Financial Institution remains aligned with Sharia principles while operating is a shared responsibility between the managers of the institution and the state institutions tasked with implementing the processes and systems, as well as the strategy, to ensure that the institution operates in the right way and does not resort to tricks (hilah) in its practices and operations (Grassa, El-Halaby, & Khlif, 2023).

Furthermore, the rapid development of Islamic Financial Institutions (IFIs) has been accompanied by increasing challenges in maintaining Sharia compliance amid financial innovation and digital transformation. Recent international studies emphasize that to ensure Islamic financial practices remain free from prohibited elements such as riba, gharar, and maysir, IFIs must strengthen Sharia governance frameworks, enhance transparency in contractual agreements, and improve internal control mechanisms (Norchaevna, 2024). Effective supervision by Sharia Supervisory Boards and regulatory authorities is essential to prevent hilah (legal stratagems) that may undermine the objectives of Islamic law (maqasid al-shariah). Consequently, the sustainability and credibility of IFIs depend not only on financial performance but also on their consistent commitment to ethical values, social justice, and full adherence to Sharia principles in all operational activities (Ahmad, Muneeza, Rahman, & Mahomed, 2023).

### *2.1 Implementation of the 5C + 1S Principles*

Implementation is the action or execution of a well-prepared and detailed plan. A principle is an attitude that is considered good and serves as a guide for decision-making. The 5C + 1S is a measure used by financial institutions to analyze and monitor financing applications from potential debtors by considering the principles (character, capacity, capital, collateral, condition of economy, and Sharia). The 5C + 1S principles serve as guidelines for financial institutions in making decisions on whether a customer is eligible for financing. By focusing on the 5C + 1S principles, financial institutions can carefully consider the debtor's ability to repay within the agreed time. There are several basic principles that need to be considered or implemented before deciding on financing submitted by potential debtors, known as the 5C+1S principle (Abbaspour, Soltani, & Tham, 2023).

The implementation of the 5C + 1S principles not only provides a systematic approach to risk assessment but also ensures that Islamic financial institutions uphold their ethical standards when making financing decisions. Each of the 5C + 1S principles—Character, Capacity, Capital, Collateral, Condition of Economy, and Sharia—plays a critical role in safeguarding an institution's financial health. By carefully analyzing these principles, institutions can avoid high-risk borrowers and mitigate the likelihood of defaults. Moreover, implementing the 5C + 1S framework aligns with the ethical and legal requirements of Islamic finance, ensuring that all financial transactions adhere to the principles of fairness and justice as outlined in Sharia law. Recent studies show that institutions applying this holistic approach not only improve loan performance but also enhance customer trust and satisfaction, leading to stronger, long-term relationships between financial institutions and their clients (Kamal, 2021).

#### *2.1.1 Character.*

Character refers to a person's traits or qualities. The character of the person to be granted financing/loan must be trustworthy. To determine the character of a potential debtor, one can examine the debtor's background, including their personal characteristics. This can serve as an indicator of the debtor's "willingness" to repay. The potential debtor must not have traits such as being a fraudster, thief, gambler, alcoholic, or a drug user. In short, the debtor must have a good reputation (Firafis, 2015). Therefore, in investigating this character, the financial institution should gather data such as B. I. Checking and information from trusted parties.

#### *2.1.2 Capacity.*

Capacity refers to the debtor’s ability to run a business to earn profits so that they can repay the loan or financing from the profits generated. This helps measure the capability of potential customers to repay their debts on time from the earnings of their businesses. Islamic financial institutions need to clearly understand the financial capability of potential debtors in fulfilling their obligations after financing is provided. The debtor's financial capacity is critical because it is the primary source of payments. The better the debtor's financial capacity, the better the potential quality of the financing. In this case, it can be ensured that the financing provided by the Islamic Financial Institution will be paid within the agreed timeframe.

#### *2.1.3 Capital.*

Capital refers to the total personal capital owned by debtors. The larger the capital of the debtor, the higher the debtor's commitment to running their business, and the more confident the Islamic Financial Institution will be in providing financing. The ability to provide capital acts as a strong barrier to withstand external shocks, such as when interest rates rise. This capital is important because banks often require a certain ratio between the loan and the debtor’s capital. Regulations on the loan-to-capital ratio may differ between banks, depending on the management practices of each institution (Maulana & Luthfi, 2025).

#### *2.1.4 Collateral.*

Collateral is an asset provided by a debtor as security for the financing received. Collateral must be valued by a financial institution to assess the risk of the debtor’s financial obligations. The evaluation of the collateral includes its type, location, proof of ownership, and legal status. In general, the consideration of collateral is known by the acronym M.A.S.T., which stands for

1. Marketability: The collateral accepted by the bank must be easily sellable at a good and increasing price over time.
2. Ascertain ability of Value: The collateral accepted must have a more certain price standard. For example, items that do not meet these criteria include paintings, antiques, heirlooms, and bird nests.
3. Stability of Value: The collateral provided must have a stable price so that when it is sold, the proceeds can cover the debtor's obligation. Therefore, stable means that the market price of the collateral does not decrease.
4. Transferability: The collateral provided by the bank must be easily transferable in ownership and can be moved from one location to another.

#### *2.1.5 Condition of Economy.*

The condition of the economy refers to assessing the current economic, social, and political conditions and their projections for the future that may affect the debtor’s business development. The assessment of the condition or business plan to be financed should have a solid plan so that the risk of problems in the financing process is minimized.

The economic conditions that need to be highlighted include the following

1. Marketing, demand, purchasing power, market size, industry trends, competition, and the role of substitute products.
2. Production technology, technological developments, availability of raw materials, and sales methods (cash or financing).
3. Government regulations, including the potential impact on the products produced. For example, a ban on the circulation of certain medicines (Waroi, Umar, & Ngutra, 2025).

#### *2.1.6 Sharia*

Sharia can be interpreted as the law, regulation, or provisions of Allah for His servants, which were revealed to the Prophet Muhammad and recorded in the Qur’an and Hadith. Sharia regulates and supervises human behavior to ensure that it stays on the right path. Three fundamental things are required to understand Sharia: faith, morals, and Fiqh. Sharia plays a crucial role in economic activities, as it is used as a supervisor for economic products to ensure they do not violate Islamic principles. The Sharia principle in financing is applied to ensure that the business being financed does not violate Allah’s rules and complies with the fatwa of the DSN. Hadratullah and Sejati (2024) found that in analyzing micro-financing at Bank BRI Syariah Surabaya, the 5C+1S analysis was used to prevent the occurrence of bad loans caused by two factors: internal and external factors.

The steps taken by Bank BRI Syariah addresses bad loans through the Standard Operating Procedure (SOP) determined by the BRI Syariah Surabaya branch and the use of 5C+1S as a preventive measure against bad loans. Research conducted by Abdeljawad et al. (2024) only used the aspects of Capacity and Condition of Economy as supporting factors to strengthen the data of potential customers. This is almost the same as the research conducted by Muhammad and Melemi (2021), who found that in practice, only 3C and 1S were used: Character, Capacity, Collateral, and Sharia. Based on these studies, it can be seen that there are differences in analysis or observations made by financial institutions in deciding financing, and this diversity of analysis in decision-making on financing provision is worth studying further

### *2.2 Financing Provision*

The process of providing financing is a strategy or step to collect data from the potential debtor needed to provide financing. Before accepting a financing application from the debtor, creditors must gather data, either directly from the debtor or through interviews with various parties, and investigate other supporting factors (Fitriyani, Handayani, & Sari, 2025). Before granting financing to a potential debtor, financial institutions must ensure that they have a clear scheme, stages, and rules to be followed. As stated in Article 29, Paragraph 3 of the Banking Law, which requires the distribution of credit or other financing based on Sharia principles for other business activities, financial institutions are obligated to use the best methods to avoid harming both parties, i.e., the interests of the financial institution and the customer (Rahmayanti, Batin, Suryati, Ariyani, & Ifada, 2023).

In addition, the financing provision process in Islamic Financial Institutions emphasizes a comprehensive assessment of the prospective debtor’s feasibility and risk profile through both qualitative and quantitative approaches. This assessment commonly includes an evaluation of business sustainability, cash flow projections, character, capital adequacy, collateral, and compliance with Sharia principles, often referred to as the 5C framework, adapted to Islamic finance. Such an approach is essential to ensure prudence, minimize financing risks, and maintain a balance between profitability and social responsibility. By applying structured financing stages and rigorous due diligence, Islamic Financial Institutions aim to achieve sustainable financing growth while safeguarding the interests of both the institution and customers in accordance with Sharia objectives (*maqasid al-shariah*) (Primambudi & Maarif, 2024)

## 3. Research Methodology

The method used in this research is a Literature Review. The Literature Review method is a research approach used to refer to, collect, analyze, and synthesize findings from existing studies on a specific topic focus, enabling researchers to systematically examine what has been previously studied and identify research gaps. This method allows for the integration of diverse findings, critical evaluation of methodologies, and construction of a coherent theoretical framework based on the existing literature (De Cassai, Dost, Tulgar, & Boscolo, 2025).

In this study, a literature review was conducted in several structured stages. First, this study focuses on a specific problem related to the effectiveness and implementation of Islamic banking financing principles. This step aimed to delimit the scope of the study and ensure that the selected literature directly contributed to answering the research questions. Second, the collected literature was analyzed and critically evaluated based on the research discussion. This process involves comparing the findings of various studies, assessing their methodologies, determining their strengths and limitations, and identifying patterns and gaps across the body of literature. Structuring the review with clear inclusion criteria improves the validity and reliability of interpretation (Tingelhoff, Brugger, & Leimeister, 2025).

Third, a clear framework of thought is developed from the formulation of the problem to be studied or understood. The conceptual framework serves as a guide that connects key theories, concepts, and empirical evidence from the reviewed literature, enabling a systematic interpretation of the research focus (De Cassai et al., 2025). Finally, various data collection methods were employed to obtain data from the same sources, such as international journal articles, books, and reputable academic databases. The selection of sources was based on relevance, publication quality, and methodological rigor to ensure that the findings of the literature review were valid, reliable, and academically sound.

## 4. Results and Discussions

When an Islamic Financial Institution provides a loan to a customer, the institution naturally expects its money to be repaid. To reduce the risk of non-repayment, it is important to assess the eligibility of potential debtors. For example, in providing credit at an Islamic Financial Institution, several factors must be considered, such as the debtor's good intentions (willingness to pay) and ability to repay (ability to pay) the loan along with other associated costs (Puspita, 2025).

Several basic factors are important and must be considered in providing financing at an Islamic Financial Institution. This can be achieved by correctly implementing the 5C principles and ensuring transparency throughout the process. This is not much different from what is implemented in other Islamic Financial Institutions; the difference lies in its execution, as each Islamic or conventional financial institution has its own way of conducting analysis and screening, although the differences are not very prominent (Lekpek, 2018). Below is a detailed explanation of 5C + 1S (Character, Capacity, Capital, Collateral, Condition of Economy, and Sharia) based on the results of the literature review.

### *4.1 Character*

Employees at Islamic Financial Institutions, when assessing character, must evaluate the customer personally, meaning they must understand the character of the customer by communicating with them. It is also important to check whether the customer has previously had or is currently managing financing from other institutions. To verify this, Islamic financial institutions can conduct a BI check to review the customer's financing track record, including whether they have previously experienced bad debt. Character can also be assessed from each meeting between the bank and the customer, especially in terms of punctuality, such as being on time for appointments, as a person who does so can be considered to be trustworthy.

Furthermore, the Islamic Financial Institution may request data from the customer's siblings or close relatives to gain further insight into the customer's character (Alamsyah, Hafidh, & Mulya, 2025). Hadratullah and Sejati (2024) analyzed micro-financing at Bank BRI Syariah Surabaya using the 5C+1S analysis to prevent bad loans caused by internal and external factors. The most important aspect of this research is character, as it is crucial to understand a person's character, attitude, and personal traits to meet the requirements for financing provision.

### *4.2 Capacity*

To measure the debtor's capacity, Islamic Financial Institutions request financial reports if the debtor is a businessperson. If the customer's business profits are large and their personal income and expenses are stable, the institution will have more trust in the debtor's ability to repay the loan. However, the situation is different if the debtor is a salaried employee of a private company. Additional data required include the customer's bank statement, salary slip for the past three months, and other supporting documents such as purchase invoices. Paripurna, Muhajirin, and Hidayah (2025) in her research also explained that in assessing the customer's capacity, the company must examine the business run by the customer by reviewing financial reports and other documents. In contrast, Mahera et al. (2025) found that Baitul Tamwil Ummah Surabaya seeks to determine whether customers have other sources of income apart from their business or salary to prevent potential problems in the business that could later affect the customer's ability to repay.

### *4.3 Capital*

An Islamic Financial Institution usually visits the company or business location of the potential debtor. For example, if the debtor is a businessperson, the business should have been running for at least two years so that the Islamic Financial Institution can analyze the financial ratios based on the past two years of operations to measure the financial projections for the future. If the debtor is a private or government employee, the institution requires the last three months' salary slips, with a maximum financing of 45% of the monthly salary (Andriyani, Kurniawan, & Nurmalia, 2025). In fact, the customer is not only assessed based on the company's financial balance but also on the available stock inventory in the company. This is important because if the debtor suffers a loss, it can be covered by the stock inventory (which has been calculated previously).

Islamic Financial Institutions apply a comprehensive risk mitigation approach by integrating inventory assessments with other prudential financing principles. Inventory valuation is conducted to ensure that the assets are liquid, marketable, and compliant with Sharia principles, thereby strengthening the institution's capacity to manage potential default risks. This approach reflects the application of prudent financing (prudential principle) and Shariah risk management, where financing decisions are not solely based on financial statements but also on the real economic value of the underlying assets. By combining financial performance analysis, income stability, and asset-backed evaluation, Islamic Financial Institutions aim to maintain financing sustainability while minimizing non-performing financing and safeguarding the interests of both parties in line with the objectives of *masjid al-shariah* (Waruwu, 2024).

### *4.4 Collateral*

The marketability of the collateral must be considered. That is, when a collateral is sold, it must be easy to find a buyer. Furthermore, the location of the collateral must be strategic, and its condition must be assessed. Most importantly, the value of the collateral must be higher than the loan provided by the Islamic Financial Institution. Abdeljawad et al. (2024) in his research explains that there are two aspects that must be evaluated in assessing collateral: the economic aspect and the legal aspect. The economic aspect evaluates the value (price) of the collateral, while the legal aspect concerns whether the collateral meets the legal requirements to be used as security.

### *4.5 Condition of Economy*

The value of a customer's business condition is assessed by determining whether the customer's business is seasonal. This means that the business's high income is only during certain seasons. If the customer applying for financing is an employee, the employment status of the customer must be reviewed to determine whether they are a permanent employee. This status should be considered because if the customer is a permanent employee, it can be ensured that they will be able to make payments until the agreed term.

### *4.6 Syariah*

When providing financing to a customer, it must be considered whether the business being run complies with Islamic law or adheres to the fatwas issued by the National Sharia Council (DSN). In this case, when a customer applies for financing, the Islamic Financial Institution must consider aspects of the business, such as the type of goods being sold, marketing, the production process, and other aspects. If any of these aspects do not comply with Islamic Sharia, the Islamic Financial Institution has the right to reject the financing application. For example, if the business involves elements of riba, may sir, gharar, or any other elements that violate Sharia law (Zabri & Mohammed, 2018). Paripurna et al. (2025) used qualitative descriptive analysis to show that the effectiveness of applying the 1S principle on subsidized iB mortgage products at PT Bank Tabungan Negara (Persero) Tbk, Sharia Branch, is effective, as evidenced by the fulfillment of several indicators, such as the correct application of financing processes according to SOPs and caution in making financing decisions submitted by the debtor.

### *4.7 Impact of Digitalization on Loan Decision Processes in Islamic Financial Institutions*

As technology continues to advance, Islamic Financial Institutions (IFIs) are increasingly adopting digital tools to enhance their decision-making processes. Digitalization, particularly through data analytics and artificial intelligence (AI), can significantly improve the accuracy and speed of evaluating the 5C + 1S principles. For instance, AI can assist in assessing the character of a potential borrower by analyzing social media profiles, past financial behaviors, and transaction histories (Sarea, Bin-Nashwan, & Elsayed, 2021). Additionally, big data can offer a comprehensive view of a borrower's capacity and capital by evaluating real-time business performance, helping institutions to predict the risk of loan defaults with higher precision. Moreover, the integration of blockchain technology can provide a transparent and immutable record of transactions, which can improve the security of collateral evaluation and financing decisions. As digital tools become more sophisticated, they are likely to play a crucial role in reducing the risks associated with loan disbursements and increasing the efficiency of Islamic finance institutions in their loan screening processes (Fitria, 2025).

## 5. Conclusions

### *5.1. Conclusion*

Based on the results of this research, it can be concluded that implementing the 5C+1S Principles by Islamic Financial Institutions is crucial in providing financing. These principles are important for several reasons. First, Character assesses the customer's discipline by learning about their personality through references from close friends or family members, checking if the customer has existing loans from other institutions, and verifying the customer's loan data through a BI check. Second, Capacity focuses on determining whether the customer owns a business and examining the profits generated by the business on a weekly or monthly basis, as indicated by the customer's financial reports. Third, Capital emphasizes the customer's effort to prepare additional capital, particularly their personal capital.

The larger the capital, the more trust the institution places in the customer. Capital includes business location, assets, and other related resources. Fourth, Collateral focuses on the value of the collateral offered, such as land certificates, houses, or other assets. The higher the value of the collateral, the easier it is to obtain financing. Fifth, the Condition of Economy focuses on the customer's ability to manage various situations that may arise, such as a decline in production. If the associated risk is smaller, the Islamic Financial Institution will be more inclined to provide financing. Finally, Sharia ensures that the business proposed by the customer complies with Islamic Sharia principles and the fatwa of the DSN.

### *5.2. Research Limitations*

The limitations of this research are primarily related to the research process itself, as various obstacles and challenges were encountered during the course of the study. One of the main constraints was the time and place of the study.

### *5.3 Suggestions and Directions for Future Research*

Based on these findings, several suggestions are offered. It is recommended that Islamic banks utilize all aspects of the 5C+1S evaluation–Character, Capital, Capacity, Collateral, Condition of Economy, and Sharia–when providing financing. It is important not to overlook any of these factors to ensure well-informed financing decisions and minimize the risk of bad debts. Future researchers are suggested to include insights from other Islamic Economics experts on Islamic banking practices, particularly in the financing process. This will allow for further development in line with current trends and theoretical advancements in this field.

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