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INVESTIGATE THE INFLUENCE FACTORS OF MUDHARABA FINANCING TO STRENGTHEN THE CORE BUSSINES OF ISLAMIC BANKING

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Abstract: *The most appropriate financing in Islamic banks is mudharaba financing. Mudharaba requires banks and customers to execute an agreement of profit and loss sharing. Mudharaba should be a core business for Islamic banking. However, the facts show that financing is still very low (16%) compared to murabaha financing (58%) with the principle of buying and selling as in conventional banks. The aim of this study was to investigate and analyze the factors that influence the mudharaba financing in terms of customers, banks, and regulators.*

This research was conducted on the 6 Islamic Banks in Semarang, Indonesia. The data was taken from interviews, questionnaires and also derived from financial statements of Islamic banks. Descriptive statistics and inferential statistical analysis are used to analyze the data.

The empirical result shows that the effectiveness of sharia supervisory board, abide by the rules of Sharia, the level of profit sharing, and NPF has effects on mudharaba financing. While the effectiveness of the board of directors and financing deposit ratio does not affect on the Mudharaba financing.

Keywords: *Islamic Banking, Mudharaba, Financial Factor, Non-Financial Factor*

INTRODUCTION

Over the last five years, Islamic banking has shown a remarkable growth started from 1,024 offices in 2008 to 2,663 offices in December 2012. In addition, total assets of Islamic Banking also increased rapidly about 35% from 2011 to 2012. Banks conduct Islamic business activities also rise along the emergence of new Islamic banks in the form of Sharia Commercial Bank, Sharia Business Unit, and Sharia Rural Bank. More importantly, Islamic Bank produces more various products than those conventional banks. For instance, there is profit sharing funding as the core product of Islamic banks instead of fixed-rate return system in the system of conventional bank's interest. Mudharaba (Trustee Profit Sharing) and Musharaka is a direct investment in the real sector. Based on Islamic principle, return in the financial sector (profit-sharing is largely determined by the real sector. This means

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the existence of Islamic banks will be able to contribute to enhancing the growth of the real sector. Thus, this function will be realized when Islamic banks use profit and loss sharing agreement as its core product.

If Islamic banks are able to optimize profit sharing financing, then the Islamic bank will have a significant opportunity to drive the SME sector. According to Islamic Banking statistics in the period of June 2011, about 94,88% third party funds are distributed to customers (FDR) and approximately 75.71% of those funds are given out to the SME sector. This proves that the Islamic banks are focusing more on empowering SMEs.

Mudharaba by the concept of profit sharing is the best concept to be applied by Islamic banks to replace the system of interest in conventional banks. Mudharaba is expected to dominate the financing system in the Islamic bank. More specifically, profit sharing system in Mudharaba may increase productivity and then create new jobs. In addition, high amount of funding will attract customers to invest their funds in Mudharaba (Antonio, 2001). Based on data from Bank Indonesia, the amount of Mudharaba financing is always smaller than the number of murabaha financing. Murabahah financing is financing with trading principle. Mudharaba financing is about 16% each year, very small amount compared to murabaha financing in the amount of 58% each year. Mudharaba financing has not been optimally conducted even though Mudharaba is Islamic Banking core business. Thus, this study aims to find an optimization model of Mudharaba financing. This study focuses on Mudharaba financing due to its role as the investment of real sector and working capital.

Islamic banking has not reflected the actual core business because of the minimum distribution of profit sharing financing. In contrary, profit sharing financing is potential in developing the real sector. Moreover, some experts argue that non-profit sharing financing as well as murabahah is secondary financing for temporary usage in the early growth of Islamic banks (Andraeny, 2011; Antara, Musa, & Hassan, 2015).

LITERATURE REVIEW

Sharia Enterprise Theory

Triyuwono (2006) explains that the most important axioms in sharia enterprise theory underlie in any determination of the concept is God as the Creator and the Owner of all the resources exist in the world. God is the primary mandate as God is the sole and absolute owner. The resources owned by stakeholders is a mandate from God that attached a responsibility to use those wisely, by the way, God permitted (see Q.S. Al-Baqarah [2]: 254 and 267). Those verses have important implications in the application of sharia enterprise theory concepts (Triyuwono, 2006). More importantly, these verses guide us to an understanding that in every asset/property we have there are others right, such as the rights of the poor, abandoned children, and Ibnu sabil.

Mudharaba Financing

Mudharaba is a funding or investment transaction based on trust. Trust is the most important element in Mudharaba engagement. More specifically, trust is the belief of fund owner to the fund manager. Therefore, Mudharaba is also called trust financing. Fund owner or investor in Mudharaba is called beneficial ownership or sleeping partner whereas fund manager can be called managing trustee or labor partner (Syahdeini, 1999 in Wasilah, 2009).

Khan and Ahmad (2001) stated that the reasons why the scheme of profit loss sharing financing was less enthused by Islamic banks are the financing models based on profit loss sharing relatively more risky. The level of return generated can be positive or negative, depend on the final results business financed. Ascarya (2005) assumed that there are several challenges that cause less profit sharing financing in Islamic banks. These challenges are:

1. Banks tend to avoid risks about asymmetric information.
2. Higher of risk and moral hazard in the scheme of profit sharing financing.
3. The small demand for this financing scheme because customers prefer financing with margin to organize its cash flow easily.
4. Firms tend to avoid joint management or profit sharing, especially on adverse selection project.
5. Aversion to risk, for the fear of losing depositor trust if the profit sharing level declined.
6. Aversion to the effort, because handling the profit sharing is not as easy as handling a secondary financing.
7. The intense competition with commercial bank force Sharia Commercial Bank to provide less risk financing alternative.

Research Hypothesis

Based on the description above, this study has hypothesis as follows:

1. The Effect of Duties and Responsibilities of the Board of Directors / Director to the Mudharaba Financing

   The duties and responsibilities of the Board of Directors / Directors in running the sharia banking business management should be based on the precautionary principle and the principles of sharia. Mudharaba financing is financing that have the highest risk compared with other financing. Mudaharabah financing and Musharaka financing are more risky than the murabaha financing, thus it needs the precautionary principle to provide strong control in providing financing to customers. In accordance with the theory of Stewardship, the Board of Directors conduct their duties and responsibilities related to the Islamic principles in the management of operations and business of Islamic banking. Moreover, The Board of Directors under the precautionary principle is needed in running a Mudharaba financing products. The provision of financing to the customers should be considered cautiously to avoid harm in the Islamic banking. In addition, when the Board of Director capable in running their duties, the mudharaba financing transaction may improve due to small risk imposed. One of the risks that may arise in Mudharaba financing is when the fund is failed to be paid by the customers.

H1: the effectiveness of duties and responsibilities of the board of directors / directors positively effect mudharaba financing

2. The Effect of Duties and Responsibilities of Sharia Supervisory Board to Mudharaba Financing

Sharia Supervisory Board (Dewan Pengawas Syariah/DPS) has a duty to provide oversight and advisory regarding the management of Islamic banks. The existence of DPS ensure that Islamic banking will conduct fund raising and its distribution based on sharia principle. Mudharaba financing is a financing uses the principles of fairness, in which banks and customers involved can share profits whereas losses belong to all parties. The implication of the stewardship theory is the existence of the Sharia Supervisory Board, where the Sharia Supervisory Board carry out their duties and responsibilities in accordance with Islamic principles. Sharia Supervisory Board can be trusted to act in their best way for accomplishing public and shareholders interest. Furthermore, this commitment lead a trust to the Islamic banking. In one hand, public's trust will increase mudharaba financing transactions because it is believed as the most financing suited to sharia principle. Therefore, well implementation of the tasks and responsibilities by Shariah Supervisory Board will increase the number of Mudharaba financing.

H2: The effectiveness of duties and responsibilities of Sharia Supervisory Board has positive influence on mudharaba financing

3. The Effect of Sharia Compliance to Mudharaba Financing

Sharia compliance is an element of the implementation of risk management framework. One of the sharia principles in Islamic banking is that Islamic banking does not considered interest (riba) as well as conventional banking does because it is forbidden in Islam. Interest rate system applied has been proven as one of the causes of Indonesia economic recession in 1998. There is no system of interest (riba) in Islamic banking but sharing system. This system recognized as the best describes the characteristics of Islamic banking. This is because it has a smaller risk and adheres to justice principle. Sharia compliance is an absolute requirement that need to be addressed in running sharia banking operations. Based on the perspective of the customers especially in Islamic banking, sharia compliance is the core of Islamic banking's integration and credibility. Public trust and confidence towards Islamic banking is based and maintained through the implementation of sharia law principles. Thus, if sharia compliance can be conducted under the Islamic principles of financing, it is expected that the mudharaba and musharaka financing transaction grow rapidly due to the trust given by the society for Islamic banking.

H3: Shariah compliance has positive effect on mudharaba financing

4. The Effect of Sharing Level on Mudharaba Financing

Sharing level is income's distribution earned by engagement parties who are the customer and Islamic Banking. Generally, when customers want to get fund from Islamic banking, they will be influenced by profit motive. They expect competitive sharing level offered by the bank. Therefore, more competitive the sharing level offered by Islamic banking, the number of mudharaba financing will get greater.

H4: Sharing level has positive impact on mudharaba financing

5. Financing to Deposit Ratio has Negative Influence on Mudharaba Financing

Hasbi (2011) state that Financing to Deposit Ratio (FDR) indicates how much the bank's ability to repay the withdrawals made by customers and by relying on financing provided as a source of liquidity. The higher this ratio, the lower the ability of bank liquidity when customers withdraw their funds. Thus, the bank may be involved in a problem one day. Moreover, this will affect the customer's decision to use the services of Islammic Banking financing, and then influence the number of Islamic bank financing transaction.

H5: Financing to Deposit Ratio has negative influence on mudharaba financing

6. The Effect of Non Performing Financing on Mudharaba Financing

Non Performing Financing (NPF) is a financial ratio associated with the risk of financing. Non Performing Financing is used to measures the level of financing problems that need to be created an allowance. Financing problems encountered in large quantities by a bank will lower bank's operating level. If the decline in the quality of the financing and bank's profitability concerned to be harmful thus affecting their financial liquidity and solvency, Bank will be more cautious in distributing funds to the customer. In addition, this condition is supported by some studies which found that NPF has impact on mudharaba deposits.

H6: Non Performing Financing has negative effect on mudharaba financing

METHODOLOGY

Population and Sample

The population in this study is Islamic Banking in Central Java, while the sample selected is 6 Islamic Banks in Semarang. This amount is chosen because the Islamic Banks have relatively similar demographics.

Data Types and Data Analysis

Data in this study is divided into two, namely: (1) primary data; and (2) secondary data. Primary data was obtained in the form of verbal or words and subject behavior (the informant) related to the research. Whereas, the secondary data derived from the financial statements of each Islamic Banks. Data were analyzed by descriptive statistics and multiple regression with Ordinary Least Square (OLS) method. Classic assumption test is conducted to ensure that the regression model can be used to estimation needs and reduce data bias. Normality test, multicollinearity test, and heteroscedasticity test is used as classic assumption test.

RESULT

Mudharaba Financing

In the financing based on profit-sharing principle, the level of bank profits is determined by a number of business profits in accordance with the sharing principle (Pramono, 2013). The greater the percentage of Mudharaba financing, the better. Here is the result of descriptive statistics test on Mudharaba financing:

Table 1
Descriptive Statistics Test Results

	N	*Minimum*	*Maximum*	*Mean*	*Std. Deviation*
Mudharaba	44	,0001	,8228	,293697	,2116720
DD	44	1	3	1,55	,630
DPS	44	1	3	1,61	,562
KS	44	1	3	1,68	,636
TBH	44	.01	.21	,0660	,04175
FDR	44	87,13	104,83	97,0285	4,74497
NPF	44	2,22	4,77	3,2700	,67038

Mudharaba financing is calculated by using the ratio of financing Mudharaba divided by total Islamic financing. Based on test results presented in Table 1, Mudharaba financing in 2011-2014 has a minimum value of 0.0001, maximum values of 0.8228 and an average of 0.293697 with a standard deviation of 0.2116720. Standard deviation is smaller than the mean value. This means that the distribution of the data is not different or the data deviation is relatively small. Thus, the data of Mudharaba financing is quite good. Deviation standard value is smaller than the average value.

Multiple Regression Test

The t statistical test shows how far the influence of the independent variables individually in explaining the dependent variable. Based on the results of t statistical tests, the partial effect of the Board of Directors, Sharia Supervisory Board, Sharia Compliance, Islamic Bank's Size, Number of Branch Offices, Sharing Level, Mudharaba Deposit, Financing to Deposit Ratio, Non-Performing Financing on Mudharaba Financing is described in the following table.

Table 2
t Statistical Test

Model	*Unstandardized Coefficients*		*Standardized Coefficients*		
	B	*Std. Error*	*Beta*	*t*	*Sig.*
1 (Constant)	11,568	,815		14,190	,000
BD	,021	,031	,084	,659	,513
SSB	,107	,032	-,431	-3,388	,001
SC	,068	,029	,283	2,340	,023
SL	2.150	.304	.350	7.073	.000
FDR	,012	,007	,142	1,826	,075
NPF	-,470	,035	-,790	-13,298	,000

a. Dependent Variable: MF

Based on the results of multiple regression analysis, the equation model is:

MF = 11,568 + 0,021 BD + 0,107 SSB + 0,068 SC + 2.150 SL + 0.012 FDR – 0.470 NPF

Which:

MF = Mudharaba Financing

BD = Board of Directors

DPS = Sharia Supervisory Board

SC = Shariah Compliance

SL = Sharing Level

FDR = Financing to Deposit Ratio (in percentage).

NPF = Non Performing Financing (in percentage).

The test results showed that Islamic Good Corporate Governance, in this case, the Board of Directors, has no effect on Mudharaba financing. The tasks and responsibilities of the Board of Directors are conducted well. The Board of Director is already running duties and responsibilities very well. However, those efforts are incongruent with the small amount of Profit Sharing financing in banking.

Nevertheless, this research found a positive and significant effect of Sharia Supervisory Board on Mudharaba Financing. In one hand, Shariah Compliance also has a positive and significant impact on Mudharaba Financing. This finding shows that the Sharia Supervisory Board is able to carry out their duties and responsibilities well. In addition, profit sharing level that is set properly has driven a positive and significant impact of profit sharing level on mudharaba financing.

In contrary, this study has proven that there is no significant effect of Financing to Deposit Ratio (FDR) on Total Mudharaba Financing. Thus, Hypothesis 2 was rejected. This is based on the descriptive data showing that the composition of the amount of financing granted compared to the amount of public funds and own capital used has no impact on the composition of Mudharaba financing issued by Islamic banks. Moreover, a negative and significant effect (NPF regression coefficient is negative) has been found over the relationship of Non-Performing Financing (NPF) to Total Mudharaba Financing.

Here is a summary of the relationship between independent variables to dependent variable:

Table 3
Significance of Independent Variables towards Dependent Variable

Variable	*Suspected*	*Regression Result*	*Significance*
BD	+	+	Insignificant
SSB	+	+	Significant
SC	+	+	Significant
SL	+	+	Significant
FDR	-	+	Insignificant
NPF	-	-	Significant

CONCLUSIONS AND SUGGESTIONS

The descriptive study showed that all variables both dependent variable (Mudharaba financing) and independent variables described the average conditions in accordance with the existence of an Islamic bank. Furthermore, the data analysis found that Islamic Good Corporate Governance factors (Sharia Supervisory Board, Sharia Compliance) and profit sharing level has a positive and significant impact on mudharaba financing. In contrary, mom performing financing negatively effects Mudharaba financing.

Based on the result, it is concluded that profit sharing financing have to be improved as it reflects the spirit of sharia economics. More importantly, profit sharing financing is better in increasing real sector. Thus, further qualitative research about internal management in developing sharia financing access is needed.

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