The effect of Sharia Funding and Financing Product toward Profitability of Islamic Commercial Banks in Indonesia

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Abstract. As a country with the highest Muslim population in the world, Islamic banking system becomes an important element in Indonesia. However, the performance of Islamic finance has not been able to keep up with conventional financial growth. Actually, Islamic banks in Indonesia have quiet low profitability level. The profitability level can be seen from its return on assets (ROA). Islamic banks return on assets (ROA) is lower than small conventional banks. It was caused by high cost of financing and low third party funds growth of Islamic banking. Therefore, this study is aimed to examine the effect of Sharia funding and financing products toward profitability level of Islamic commercial banks in Indonesia. A quantitative approach is used by collecting the data from monthly financial statements of all Islamic commercial banks in Indonesia for the period of June 2014 until April 2019. The independent variables used for this analysis consist of Sharia funding which included Mudaraba demand and saving deposit, and also Sharia financing which included Mudaraba financing, Musharaka financing, and Qard financing, while net profit after tax becomes dependent variable which represents the profitability of Islamic commercial banks itself. A multiple linear approach was used to examine the hypotheses with fulfilling five classical assumptions. From this research, it could be found that Mudaraba saving deposit, Musharaka financing and Qard financing has a positive and significant effect on net profit of Islamic commercial banks. Meanwhile Mudaraba demand deposit and Mudaraba financing has did not have any significant relationship towards net profit of Islamic commercial banks. Another finding showed that Mudaraba saving deposit and Musharaka financing becomes the most significant influence on profitability of Islamic commercial banks in Indonesia.

Keywords: 1 Islamic banks · 2 Sharia funding · 3 Sharia financing · 4 Net profit.

1. INTRODUCTION

The role of banking system for both the macroeconomic and microeconomic activities as a whole cannot be denied. Bank has a role to collect and distribute the fund from and to the society. Currently, Indonesia uses dual banking systems which are conventional banking system and Islamic banking system. The difference point comes from the usage of predetermined interest, which is claimed as a riba and in Islamic religion, God prohibits it. Due to the highest Moslem population in Indonesia, an Islamic banking system should be incurred. However, after the last two decades of the establishment of Islamic banking in Indonesia, the growth of Islamic banking has not been able to keep up with conventional banking's growth. It can be proven by the profitability level measured by return on assets (ROA) which is still lower than the conventional

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banks [3]. The reason why the profitability level of Islamic bank is still lower is due to the several problems. The Director of Sharia Banks of Financial Service Authority, Dhani Gunawan Idhat on Rahmah [10], said that one of the problems of Islamic banking is the high cost of financing offered that made the customers tend to choose the conventional one which is quiet cheaper. Another problem faced by Islamic banks in Indonesia is the high financial problem which is caused by the financing provided by Islamic banks is a real financing, which is in a declining economic cycle, with funding expansion are slowing down. This condition caused a decline in asset quality and increased problem financing. In other sides, the third party fund of Islamic banks in Indonesia is still under the expectation. According to the notes of Indonesia Financial Service Authority, the third party funds of Islamic banks for the period of January 2019-April 2019 is still below the current year projection, which the growth was also in the same amount with the previous period that is only 6%-7%. The slow growth of third party funds has not been able to keep pace with the increased demand for credit [4]. Starting from that problem, researcher wants to know the effect of Sharia funding and financing products toward the profitability level of the Islamic banking in Indonesia, which is aimed to 1) know the relationships between Sharia funding and financing products toward the profitability of Islamic commercial banks in Indonesia, 2) determine the factors those have highest contribution to the profitability level of Islamic commercial banks in Indonesia, and (3) give the recommendation for the Islamic banking system regarding to increase its profitability.

2. THEORETICAL FRAMEWORK

2.1. Basic Theory

Islamic banking is a banking system which implements the Islamic principles, with the objectives and operations are due to the Islamic law and regulations [8]. In its operational activites, Islamic banking provides several products which divided into Sharia funding and financing. Islamic banks are dependent to the depositors' money that becomes the major source of funds [7]. Therefore, Islamic banking collects the fund from several sources. However, this research only focused on third party funds., which included the demand deposit and saving deposit. Demand deposit is the deposit facility provided for those who need money for transaction purposes [7] Islamic banks also provides saving deposit for collecting the fund. Saving deposit is the funding facility that caters to the needs of those who wish to save their money, but at the same time they want to receive an income [7].

Besides Sharia funding, Islamic banking also offers Sharia financing products which become the key operational activities in order to allocate the funds and gain the revenues. There are many kinds of Sharia financing products but this research only focused on Mudaraba, Musharaka, and Qard financing. Mudaraba financing is a financing products of Islamic banking by allocating the money from the investor (Islamic banks) to another party (entrepreneur) in order to carry out a venture or businesses [7]. Musharaka can be defined as a form of partnership whereby two or more persons contribute either their capital or labor together, to share the profit, and enjoying the rights and liabilities [8]. Whereas Qard financing is the benevolent loan that obliges the borrower to repay the lender the principal sum borrowed. However, it has the discretion to reward the lender by paying any sum over and above the principal amount borrowed [7]

These Sharia funding and financing may led to influence the performance of Islamic banking, especially on profitability. Profitability reflects a company's competitive position in the market, and by extension, the quality of its management [11]. Profitability of the firms can be measured through the net profit of the firm which gotten from the substraction of revenues generated with all costs incurred during the period [5].

2.2. Previous Studies

The study of Islamic banking profitability had been conducted in several times by other researchers. Halit Yanikkaya, Nihat Gumus, and Yasar Ugur Pabuccu (2018) had compared the dynamics for the profitability of Islamic banks and conventional banks in the Organization of Islamic Cooperation (OIC) countries and the United Kingdom by using a sample of 74 Islamic and 354 conventional banks for the period from 2007 to 2013. From this analysis, they found that the usage of products which promotes more risk sharing as compared to the products based on Murabahah structure could contribute to the performance of Islamic banks [14]. Taudlikul Afkar (2017) determined the effect of mudaraba financing and qard financing on the profitability of Islamic banking in Indonesia by obtaining data from all 11 Islamic banking with the period of 2010-2014. He found that mudaraba financing did not significantly affect the profitability of Islamic banking. Meanwhile qard financing has a significant effect on the profitability of Islamic Banking in Indonesia. The R square for this analysis is 22.5% [1]. Meanwhile, Setiawan and Indriani (2016) had identified and analyzed the determinant of Islamic banking in Indonesia for the period of 2011-2015 by obtaining 5 Islamic banks in Indonesia. According to that research, they found that third party funds had positive relationship and significant to the total financing, and third party funds and total financing partially has positive association and significant to Profitability. Actually, financing can not mediate the influence between variable independent of third party funds, CAR, nad NPF to Profitability [13]. The last was come from Afrizal (2017) who had examined which one of the third party funds, quick ratio, current asset ratio, and non performing finance that has the highest contribution to the return on assets by obtaining secondary data which taken from annual report of PT Bank Syariah Mandiri Indonesia. According to his research, it could be found that all independent variables are simultaneously affect to the profitability measured by ROA. Meanwhile for the partial test, a quick ratio, current assets ratio, and third party funds did not affect significantly to the ROA. The R square for this analysis is about 77.2% [2].

2.3. Hypotheses Building

The hypotheses built for examining the association of Sharia financing products which included Mudaraba financing, Musharaka financing, and Qard financing toward the net profit of Islamic commercial banks are as follows.

1) H1: Mudaraba demand and saving deposit affect simultaneously to the net income of Islamic commercial banks
2) H1: Mudaraba demand deposit has a significant relationship with the net income of Islamic commercial banks
3) H1: Mudaraba saving deposit has a significant relationship with the net income of Islamic commercial banks
4) H1: Murabaha, Musharaka, and Qard financing affect simultaneously on the net income of Islamic commercial banks
5) H1: Mudaraba financing has a significant relationship with the changes on the net income of Islamic commercial banks
6) H1: Musharaka financing has a significant relationship with the changes on the net income of Islamic commercial banks
7) H1: Qard financing has a significant relationship with the changes on the net income of Islamic commercial banks

3. RESEARCH METHODOLOGY

In this analysis, a purposive sampling technique was used with the characteristics of the population are Islamic commercial banks in Indonesia and the availability data of Mudaraba demand deposit, Mudaraba saving deposit, Mudaraba financing, Musharaka financing, Qard financing, and net profit after tax. All 14 Islamic commercial banks in Indonesia are involved in

this analysis. Meanwhile, for obtaining the time-series data, it is only involved the data from the period of June 2014-April 2019 [9].

Actually, there are several variables that would be generated, which divided into two types. The first one is independent variable. The independent variables used for this research consist of five variables, which are defined as follows.

X1= Total amount of Mudaraba demand deposit (MDD) in billion rupiahs for the period of June 2014-April 2019

X2= Total amount of Mudaraba saving deposit (MSD) in billion rupiahs for the period of June 2014-April 2019

X3= Total amount of Mudaraba financing (MUD) in billion rupiahs for the period of June 2014-April 2019

X4= Total amount of Musharaka financing (MUS) in billion rupiahs for the period of June 2014-April 2019

X5= Total amount of Qard financing (QRD) in billion rupiahs for the period of June 2014-April 2019

Meanwhile for dependent variable used for this analysis is only profitability level, which is represented as follows.

Y = Net profit of Islamic commercial banks (PRO) in billion rupiahs for the period of June 2014-April 2019.

In this analysis, a Multiple linear regression can be conducted, in which a general statistical technique used to analyze the relationship between a single dependent variable and several independent variables [6]. The output of this analysis is the significance test results consists of F-test and t-test; and the equation that describes the relationship of independent variables and dependent variables. The F test analysis provides the statistical analysis to measure the simulant influence among the variables or the overall model fit in terms of F-stat [6]. Meanwhile, the t-Test is used to measures the significance of the partial correlation of each variable [6]. This test examines whether each of independent variable have significant influence to the dependent variable or not. Besides using F-test and t-test, the relationships between the independent variables with the dependent variable can be expressed through a Multiple Linear Regression equation as follows.

Equation for Islamic Bank's Funding Products

$$PRO = \alpha 1 + \beta 1\ (MDD) + \beta 2\ (MSD) + \varepsilon 1$$

Equation for Islamic Bank's Financing Products

$$PRO = \alpha 2 + \beta 4\ (MUD) + \beta 5\ (MUS) + \beta 6\ (QRD) + \varepsilon 2$$

Where αx = constant of each equation
βx = coefficient of each independent variable
εx = error of each equation

Instead of the equation, this analysis could also measure the goodness of fit, which could be measured from the coefficient of determination (R square). The higher the value of R-square, the higher the variance of dependent variable can be determined by the variance of independent variables. From this analysis also, it could determine the partial correlation, which is the value that measures how strong the relationship between the single independent variable and its

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dependent variable when the predictive effects of the other independent variables are removed from multiple linear regression model [6].

4. RESEARCH FINDINGS

4.1. Classical Assumptions

Actually there are five classical assumptions that must be fulfilled before analyzing the data using Multiple Linear Regression model. Table 1 below shows the result of all five classical assumptions for this research.

Table 1. Classical Assumptions' Results

Classical Assumption		Sig.	VIF	DW	Conclusion
Normality	Model 1	0.122			Normally distributed
	Model 2	0.706			Normally distributed
Multicollinearity	Mudaraba Demand Deposit		6.861		No multicollinearity
	Mudaraba Saving Deposit		6.861		No multicollinearity
	Mudaraba Financing		7.928		No multicollinearity
	Musharaka Financing		7.259		No multicollinearity
	Qard Financing		1.343		No multicollinearity
Heteroscedasticity	Mudaraba Demand Deposit	0.559			No heteroscedasticity
	Mudaraba Saving Deposit	0.173			No heteroscedasticity
	Mudaraba Financing	0.310			No heteroscedasticity
	Musharaka Financing	0.866			No heteroscedasticity
	Qard Financing	0.227			No heteroscedasticity
Autocorrelation	Model 1			0.680	No autocorrelation
	Model 2			0.859	No autocorrelation

The first one is Normality, which refers to the form of the data distribution to an individual metric variable and its correspondence to the normal distribution [6]. According to Table 1, the asymptotic significance value is greater than 0.1. Therefore, the data that wanna be analyzed were normally distributed. The second assumption is multicollinearity, which refers to the correlation among three or more independent variables [6]. It could be determined by looking at the Variance Inflation Factor (VIF). According to the Table 1 above, since the VIF value is less than 10, it could be concluded that there was not any association among the independent variables. Homoscedasticity refers to the assumption that dependent variable exhibit equal levels of variance across the range of independent variables [6]. From the Table 1 above, since the significance value of each variable was greater than 0.05, then it could be concluded that there was no heteroscedasticity within the data. Autocorrelation is used to see that there is a linear relationship between the errors on a series of observations sorted by time. The data could be free from an autocorrelation if the value of Durbin-Watson value is between 2 and -2 [12]. By looking at the Table 1, the coefficient of Durbin Watson was within the range of 2 and -2. Hence, there is no autocorrelation within the data. And the last is linearity which is used to express the concept that the model possesses the properties of additivity and homogeneity [6]. A linearity could be assessed through the normal probability plot of regression standardize residual.

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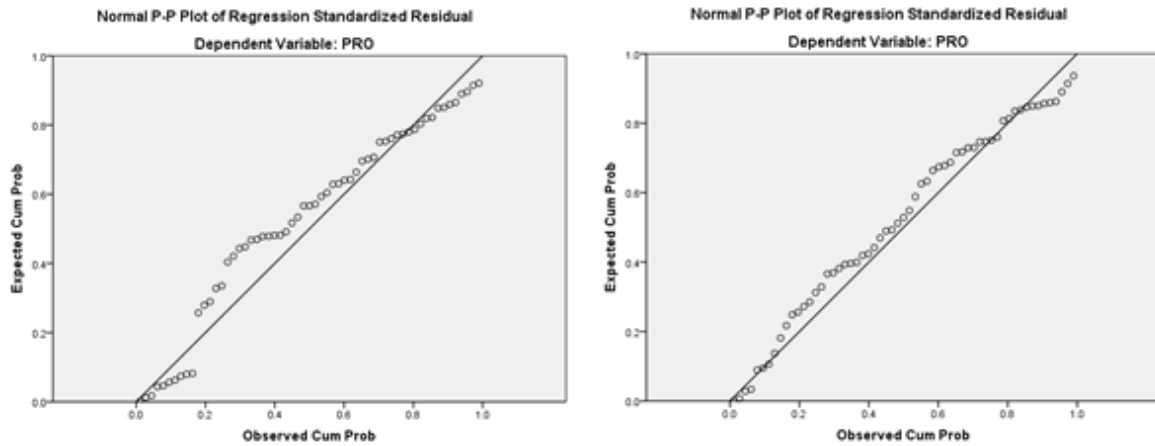
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Figure 1. Normal Probability Plot of Model 1 (left) and Model 2 (right)

According to Figure 1 above, the plots were approximately near with the line and those plots also tried to follow the line. This condition caused the data became linear.

4.2. Hypothesis Testing

To test the hypotheses, an F-test and t-test analysis are conducted. The F test analysis provides the statistical analysis to measure the simultant influence among the variables or the overall model fit in terms of F-stat [6].

Table 2. F Test Result of Model 1 (left) and Model 2 (right)

ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	65896477	2	32948239	91	0.000
	Residual	20202906	56	360766.19		
	Total	86099383	58			

a. Predictors: (Constant), MDD, MSD
b. Dependent Variable: PRO

ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	69402955	3	23134318	76	0.000
	Residual	16696429	55	303571.4		
	Total	86099383	58			

a. Predictors: (Constant), MUD, MUS, QRD
b. Dependent Variable: PRO

According to the Table 2 above, it could be seen that the significant value of F for both model 1 and 2 is 0.000 which was lower than 0.05. then H1: There is a simultant relationship between Mudaraba demand and saving deposit against the net income of Islamic commercial banks, and H1: There is a simultan relationship between Mudaraba financing, Musharaka financing, and Qard financing against the net income of Islamic commercial banks, was accepted.

Beside F test, the t-test is used to measures the significance of the partial correlation of each variable [6]. Those hypotheses could be tested by comparing the t-stat of each variable with the value of t-table with significance level is 0.05.

Table 3. T-Test Result of Model 1 (left) and Model 2 (right)

Model		t	Sig.
	(Constant)	-2,273	0.027
1	MDD	1,912	0.061
	MSD	3,341	0.001

a. Dependent Variable: PRO

Model		t	Sig.
	(Constant)	0.145	0.885
1	MUD	-1.775	0.081
	MUS	3.15	0.003
	QRD	2.959	0.005

a. Dependent Variable: PRO

According to the Table 4, the result of t-test could be explained as follows:

1) Mudaraba demand deposit has t-stat of -2.004<1.912<2.004,. Then, H0 was accepted, which means that there is not any significant relationship between Mudaraba demand deposit with the net profit of Islamic commercial banks.
2) Mudaraba saving deposit has t-stat of 3.341>2.004. Then, H0 was rejected, which meant that there is a significant relationship between Mudaraba saving deposit with the net profit of Islamic commercial banks.
3) Mudaraba financing has t-stat of -2.003>-1.175>2.002. Then, H0 was accepted, which means that there is not any significant relationship between Mudaraba financing with the net profit of Islamic commercial banks.
4) Musharaka financing has t-stat of 3.150>2.004. Then, H0 was rejected, which means that there is a significant relationship between Musharaka financing with the net profit of Islamic commercial banks.
5) Qard financing has t-stat of 2.959>2.004. Then, H0 was rejected, which means that there is a significant relationship between Qard financing with the net profit of Islamic commercial banks.

4.3. MLR Equation
The multiple linear regression equation for the first model could be determined as follows.

First Model

$$PRO = -1,916.51 + 0.083 \, (MDD) + 0.075 \, (MSD) + \varepsilon 1$$

From the equation above, it could be determined that the constant value is -1,916.51, in which if all of the variable is zero, the amount of net profit would be equal with -1,916.51 billion rupiahs.

Besides the constant value, the coefficient of Mudaraba demand deposit is 0.083. However, this independent variable is not significant to the model. Hence, there is no conclusion whether an increase in Mudaraba demand deposit could affect to the profitability level represented by net profit of Islamic commercial banks itself. This result is in accordance with Afrizal [2]. Currently Mudaraba demand deposit has a small amount and it did not differ significantly among the period. It can be caused by the low return paid to the customers. Therefore, it could cause insignificant effect of Mudaraba demand deposit toward the net profit of Islamic commercial banks.

Another variable is Mudaraba saving deposit, with the coefficient of regression of its variable is 0.075. It could be stated that Mudaraba saving deposit has a positive relationship with the net profit of Islamic commercial banks. If Mudaraba saving deposit grows by one rupiah, it can affect to the increase the amount of the net income which becomes 0.075 rupiah. This result is supported by Setiawan and Indrianti [13]. Actually, the high amount of Mudaraba saving could describe that Islamic banks had successfully gained the fund from the society effectively. Besides that, the funds collected has been distributed well to several projects or businesses that can expectly generate the profit to the Islamic banks itself.

Second Model

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$$PRO = 372.76 - 0.327 \ (MUD) + 0.065 \ (MUS) + 0.195 \ (QRD) + \varepsilon2$$

According to the multiple linear regression equation above, it can be determined that the constant value is 372.76, in which if the net profit cannot be determined by the following variables, the amount of net profit is equal with 372.76 billion rupiahs.

Besides the constant value, it could be determined that the coefficient of Mudaraba financing is -0.327. However, this independent variable is not significant to the model. Hence, there is no conclusion whether Mudaraba financing could affect to the profitability level represented by net profit of Islamic commercial banks itself. This finding is supported by Afkar [1]. Mudaraba is categorized as a profit-loss-sharing financing, in which the Islamic banks had a role as a fund provider for the business with the return is based on the proportion of profit generated and losses borne because of the business. However, in Mudaraba principle, Islamic bank did not intervene too much to the business. Hence, the risks borne by the bank is fully caused by the management of the business itself. Moreover, the amount of Mudaraba financing within the period of analysis is not dominant as much as Musharaka financing. Therefore, Mudaraba does not affect significantly to the ROA level of Islamic banks.

Another variable in the equation above is Musharaka financing, with the coefficient of its variable is 0.065. From the coefficient value, it can be stated that Musharaka financing has a positive association with the net profit of Islamic commercial banks. If Musharaka financing grows by one billion rupiah, it can affect to the increases of the net income which becomes 0.065 rupiah. This result is also supported by the research conducted by Yanikkaya et al. [14]. Musharaka financing principles placed Islamic banking as an investor (*rab ul maal*), not as a lender. Thus, Islamic banks had a responsibility to manage the business financed by them and it can affect to the managerial decisions of the business. This high involvement of Islamic banks towards the business will reduce the risk of business failure or mismanagement of the business. Therefore, it could generate higher return for the Islamic banks.

Besides that, the variable that affect to the net profit of Islamic commercial banks is Qard financing. This independent variable has a coefficient as much as 0.195. It means that there is a positive association between Qard financing with the net profit of Islamic commercial banks. If Qard financing has increase by one billion rupiah, then it will affect to the increases on net profit of Islamic commercial banks by 0.195 billion rupiah. This finding is in accordance with the research conducted by Afkar [1]. Actually, this principle did not generate any profit-sharing or even mark-up margin from this transaction. However, the customers might have to give some additional return to the banks as a gratitudes for permissing a loan. Moreover, Qard financing becomes one of the characteristics of Islamic banking which have social mission that can increase its brand image and customers loyalty. Therefore, Qard financing could contribute to the increases of net profit of Islamic banks in Indonesia.

4.4. Partial Correlation
A partial correlation could determined about the strongest relationships of each independent variable towards the dependent. The calculation could be deined as follows.

Table 4. Correlation of Sharia Funding Products

Variable	Pearson Correlation	Standardized Coefficient	Partial Correlation
MDD	0.848	0.324	0.2747
MSD	0.866	0.566	0.4902

Refer to the Table 4. It could be concluded that the correlation of Mudaraba demand deposit was 27.47% against the net profit of Islamic commercial banks in Indonesia. Whereas, for Mudaraba saving deposit, it has 49.02% correlation against the net profit of Islamic commercial banks in Indonesia. Hence, Mudaraba saving deposit has the highest contribution of Islamic funding products to the net profit of Islamic commercial banks in Indonesia.

Table 5. Correlation of Sharia Financing Products

Variable	Pearson Correlation	Standardized Coefficient	Partial Correlation
MUD	-0,865	-0,297	0.2569
MUS	0.864	0.504	0.4355
QRD	0.560	0.204	0.1142

Refer to the Table 5. It could be concluded that partially the correlation of Mudaraba financing was 25.69% against the net profit of Islamic commercial banks in Indonesia. Whereas, for Musharaka financing, it has 43.55% correlation against the net profit of Islamic commercial banks in Indonesia. Qard financing has 11.42% contribution to the net profit of Islamic commercial banks in Indonesia. Therefore, Musharaka financing has the highest contribution of Islamic funding products to the net profit of Islamic commercial banks in Indonesia.

4.5. Coefficient of Determination

Table 6. Coefficient of Determination of Model 1 (left) and Model 2 (right)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.875	0.765	0.757	600.6381

a. Predictors: (Constant), MDD, MSD

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.898	0.806	0.796	550.9732

a. Predictors: (Constant), MUD, MUS, QRD

Table 6 showed that the coefficient of determination (R square) value is 0.765 which means 76.5% of the variance of net profit (PRO) as dependent variable can be determined by the variance of Mudaraba demand deposit (MDD) and Mudaraba saving deposit (MSD) as the independent variables. Meanwhile, the coefficient of determination (R square) value for the second model is 0.806 which means 80.6% of the variance of net profit (PRO) as dependent variable can be determined by the variance of Mudaraba financing (MUD), Musharaka financing (MUS), and Qard financing (QRD) as independent variables.

5. CONCLUSION

5.1. Conclusion

According to the analysis, it could be concluded that Mudaraba saving deposit, Musharaka financing, and Qard financing has positive relationship toward the net profit of Islamic commercial banks in Indonesia, in which Mudaraba saving deposit and Musharaka financing become the variable that has the highest contribution on its net profit. Meanwhile, Mudaraba demand deposit and Mudaraba financing did not affect significantly on the net profit of Islamic commercial banks in Indonesia.

5.2. Recommendation

To increase Islamic commercial banks' ability to generate higher profit, they can increase Mudaraba saving deposit, Musharaka financing, and Qard financing, with improving the management and efficiencies on its operation to minimize the risk of its products. Instead of the recommendation for Islamic banking's development, other researchers can seek other opportunities for conducting research of Islamic banking further. Starting from the extension of period and number of Islamic banks analyzed, extending the sample by adding Islamic business units and Islamic rural banks in their analysis, involving other factors such as CAR, ROE, OER, NOM, and NIM, or even involving the external factors such as inflation, GDP, Central bank's discount rate, and any other factors that might be influence the profitability level of Islamic banking in Indonesia.

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