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ARE SHARIA FINANCING SCHEMES PROFITABLE? THE CASE OF ISLAMIC RURAL BANKS IN INDONESIA

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Abstract

Some studies find that Profit and Loss Sharing/PLS (mudharabah and musyarakah) and non-PLS (murabahah) financing positively affect Islamic banks' profitability, while other studies have found a negative relationship. This study aims to analyze the effect of PLS and non-PLS financing on the performance of Islamic banks, as proxied by the profitability ratio of ROA (Return on Assets) with the Non-Performing Finance (NPF) as a moderating variable on six Islamic Rural Banks (IRBs) using panel regression and moderated regression analysis. It finds that the PLS and non-PLS financing positively and significantly influence the IRBs' profitability. NPF as a moderating variable has weakened the effect of PLS financing on the IRBs' profitability. Meanwhile, NPF strengthens the effect of non-PLS financing on the IRBs' profitability. PLS financing with NPF can reduce the IRBs' profitability, and non-PLS financing with NPF can increase the IRBs' profitability. These findings explain why murabahah is still the dominant financing in Islamic banks. Islamic banks should strive to achieve their ideal form as a profit-sharing financial intermediary to respond to the criticism that there is no substantial difference between Islamic and conventional banks as both rely on fixed returns in the financing, perceived as similar to riba, prohibited in Islam.

Keywords: *Islamic Rural Bank (IRB); PLS; Mudharabah; Musyarakah; Non-PLS; Murabahah; Non-Performing Finance; Profitability*

Abstrak

Beberapa penelitian menemukan bahwa Pembiayaan Profit and Loss Sharing/PLS (mudharabah dan musyarakah) dan non-PLS (murabahah) berpengaruh positif terhadap profitabilitas bank syariah, sementara penelitian lain menemukan hubungan negatif. Penelitian ini bertujuan untuk menganalisis pengaruh pembiayaan PLS dan non-PLS terhadap kinerja bank syariah yang diproksikan dengan rasio profitabilitas ROA (Return on Assets) dengan Non-Performing Finance (NPF) sebagai variabel moderasi pada enam Bank Pembiayaan Rakyat Syariah (BPRS) menggunakan regresi panel dan analisis regresi moderat. Ditemukan bahwa pembiayaan PLS dan non-PLS secara positif dan signifikan mempengaruhi profitabilitas BPRS NPF sebagai variabel moderasi memperlemah pengaruh pembiayaan PLS terhadap profitabilitas BPRS. Sementara, NPF memperkuat pengaruh pembiayaan non-PLS terhadap profitabilitas BPRS. Pembiayaan PLS dengan NPF dapat mengurangi profitabilitas BPRS dan pembiayaan non-PLS dengan NPF dapat meningkatkan profitabilitas BPRS. Temuan ini menjelaskan mengapa murabahah masih menjadi pembiayaan dominan di bank syariah. Bank syariah harus berusaha untuk mencapai bentuk ideal mereka sebagai perantara keuangan bagi hasil untuk menanggapi kritik bahwa tidak ada perbedaan substansial antara bank syariah dan konvensional karena keduanya mengandalkan pengembalian tetap dalam pembiayaan, dianggap mirip dengan riba, dilarang dalam Islam.

Kata kunci: Bank Pembiayaan Rakyat Syariah (BPRS); PLS; Mudharabah; Musyarakah; non-PLS; Murabahah; Pembiayaan Bermasalah; Profitabilitas

INTRODUCTION

Islamic banking is essentially a development of the concept of Islamic economics, offered by Muslim economists and practitioners seeking to accommodate the demand from many Muslims to have Islamic-based financial transaction services deriving from Sharia values and principles (Islam & Ashrafuzzaman, 2016). As the community's economic activity increases, financial institutions' role increases. Among several Islamic banks in Indonesia, Islamic Rural Bank (IRB) is the community's choice to develop micro, small, and medium enterprises and provide financing to small and medium-sized communities.

The development of conventional Rural Banks and the Islamic Rural Banks industry continue to increase rapidly, with a margin share of 2.62% for IRB, based on Financial Services Authority (OJK) data. Until January 2020, 164 IRBs were spreading and operating throughout Indonesia. Table 1. shows that the scope of IRB services is getting more expansive, and the community increasingly needs its existence (OJK, 2020). In addition, overall economic freedom has a strong positive impact on the efficiency of Islamic IRBs, such as business freedom, government spending, and investment freedom (Hamidi & Worthington, 2021; Warninda & Maryani, 2022; Miranti & Oktaviana, 2022).

In January 2019, the total murabahah financing amounted to 6,901,676 million rupiahs. Meanwhile, musyarakah financing was 806,428, and mudharabah financing was 179,662. In January 2020, the total murabahah financing was 7,711,400 million rupiah. Meanwhile, musyarakah financing was 1,135,809 million rupiah, and mudharabah financing was 220,848 (OJK, 2020). This shows that murabaha financing has a greater contribution than financing on a profit sharing basis, namely mudharabah and musyarakah financing. The management of financing at banks needs attention to maintain economic security. Bank profitability is one of the things that must be considered in preserving the safety of the banking industry.

Murabahah, musyarakah, and mudharabah financing are factors affecting an IRB's performance in Indonesia. It can be seen from the level of profitability, which is measured using financial ratios. The financial ratio usually used to assess profitability is the ROA, which measures the profit level of the company's assets. Figures 2 and 3 indicate the fluctuating rates of murabahah, musyarakah, and mudharabah financing and Return on Assets of the IRBs every year. It is interesting to assess whether the difference in financing schemes between the PLS scheme (mudharabah and musyarakah) and non-PLS scheme (Murabahah) influence the performance of IRBs, particularly their profitability, as proxied by Return on Asset (ROA).

As demonstrated by Figure 3, the ROA of IRBs fluctuated and relatively decreased until January 2020, assuming that increased financing was related to a decrease in ROA (OJK, 2020). There has been academic debate on the relationship between Shariah financing and the performance of Islamic banks. Satriawan & Arifin (2012) found that PLS and non-PLS financing positively affected the profitability of Islamic commercial banks. Kuswara, Puji Lestari, & Retnaningsih (2019) states that PLS financing positively and significantly affects profitability. However, Yusuf et al.. (2019) and Suwasdi et al.. (2021) found that PLS financing has not significantly affected the ROA of Islamic Banks. In non-PLS financing, Yusuf et al.. (2019) state that non-PLS financing positively affects profitability. However, Dewantara & Bawono (2020) state *that* non-PLS financing does not significantly affect Islamic commercial banks' profitability.

Table 1. Composition of Financing provided by the Islamic Rural Banks (2016-2020)

Contract	2016	2017	2018	2019	2020
Mudharabah	156,256	124,497	180,956	179,662	220,848
Musyarakah	774,949	776,696	837,915	806,428	1,135,809
Murabahah	5,053,764	5,904,751	6,940,379	6,901,676	7,711,400
Salam	14	0	0	0	0
Istishna	9,423	21,426	35,387	35,812	67,238
Ijarah	6,763	223,316	46,579	47,548	48,961
Qardh	145,865	189,866	185,360	185,534	201,370
Multiservice	515,523	724,398	857,890	879,933	941,975
Total	**6,662,556**	**7,763,951**	**9,084,467**	**9,036,594**	**10,327,603**

Source: Sharia Banking Statistics, OJK (2020)

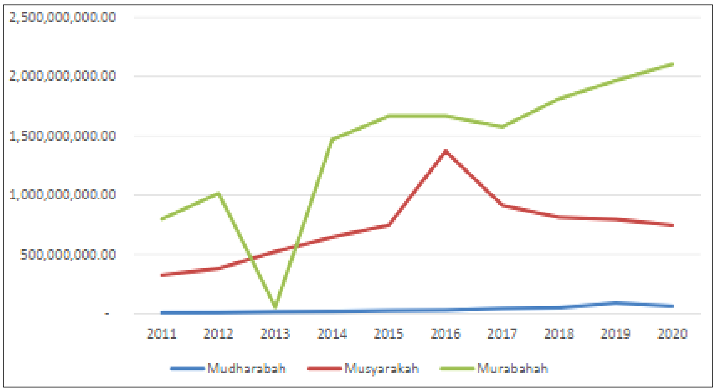

Figure 2. The Dominant Composition of Financing in BPRS (2011-2020)
Source: Sharia Banking Statistics, OJK (2020)

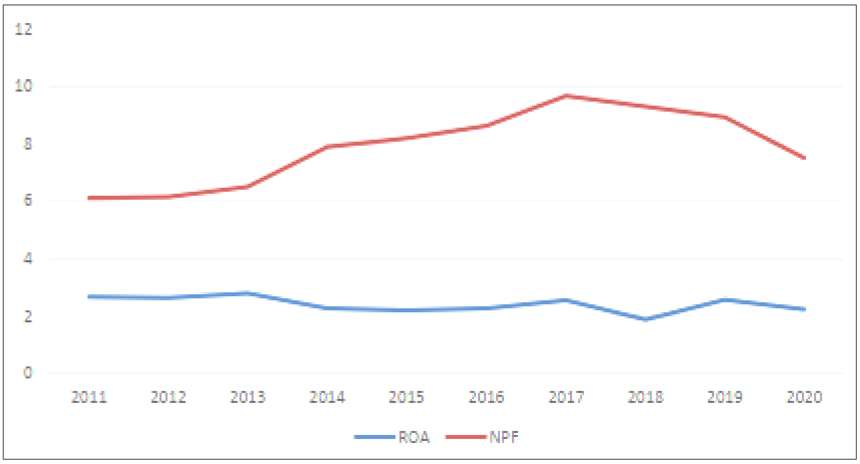

Figure 3. Financial Ratios of Islamic Rural Banks (2011-2020)
Source: Sharia Banking Statistics, OJK (2020)

In disbursing financing, IRBs must manage the risk, particularly Non-Performing Financing (NPF). If the NPF ratio continues to increase, it implies that financing provided by IRBs faces problems. The higher the NPF of a bank indicates the increasing amount of problematic financing, so the Bank will experience difficulties repaying the third parties' funds. It also means that the higher the NPF, the lower the profitability; conversely, the lower the NPF, the higher the profitability. Some previous studies assessing the role of NPF in mediating the relationship between the different schemes of financing and profitability also demonstrate contradicting results. According to Agustin et al.. (2018) and Afkar (2018), the NPF from PLS financing significantly negatively affects the profitability of Sharia banks. The results indicate that NPF can reduce the profitability of Sharia banks in PLS financing. Meanwhile, research conducted by Mulyaningsih & Fakhruddin (2016) states that the NPF from PLS financing significantly and positively affects the profitability of

Islamic commercial banks. It means that NPF does not reduce the ability to earn profits.

In non-PLS financing, Pujiyanty, Puspita, & Mochlasin (2022) states that non-PLS moderated by NPF negatively and significantly affects profitability in Islamic Commercial Bank in Indonesia. Meanwhile, Masnah & Hendrawati (2020) state that non-PLS financing moderated by NPF positively and significantly affects profitability. That means NPF strengthens the effect of non-PLS financing on the profitability of Islamic Commercial Banks. Due to such contradictory results of the previous studies, this study would like to further investigate the role of NPF as a moderating variable on the relationship between shariah financing (PLS and non-PLS) schemes and the profitability of Islamic banks.

Previous research on financing has demonstrated the discrepancy between the existing theory and the empirical studies. Therefore, the authors are interested in analyzing the effect of the different financing schemes, between PLS (mudharabah and musyarakah) and non-PLS (murabahah), on the profitability of Islamic banks by taking into account NPF as a moderating variable. Previous studies have mainly focused on Islamic Commercial Banks. In this study, the authors are interested in assessing the Islamic Rural Banks (IRBs) because the role of IRBs in Indonesia is quite significant since IRBs can reach Micro, Small, and Medium enterprises, the backbone of the Indonesian economy. Hence, IRBs have significant potential to empower the lower middle class of society, as the vision of Islamic banks is to align and empower the less advantaged class of society.

LITERATURE REVIEW

Financing based on Sharia principles can be divided into Profit and Loss Sharing (PLS) and Non-Profit and Loss Sharing (Non-PLS) financing. PLS contains the principle of *al-gunm bil gurm* and *al-kharāj bi ad-daman*, meaning there is no profit sharing without taking risks. The product forms based on this principle are mudharabah and musyarakah financing. Mudharabah and musyarakah are the investment of funds using the distribution of a profit-sharing scheme between investors (*shahibul maal*) and business managers (*mudharib*) based on a pre-agreed ratio. Mudharabah financing is fully financed by investors (*shahibul maal*), while business managers (*mudharib*) only run the business without investing funds. Meanwhile, in musyarakah financing, capital is provided by two or more parties to obtain profit from a jointly managed company.

Islamic finance theory assumes that PLS is an efficient system because the intermediary financial function is expected to work well are allocated based on the level of profitability. PLS is considered fair because the profits derived from investments are distributed evenly between the owners and users of funds. The distribution of profits is based on the actual rate of return on capital (Iqbal and Mirakhor, 1987 in Hidayah, 2011). However, it is recognized that the efficient performance of such a financial system is based on the assumption that there are well-organized primary and secondary markets. Khan and Mirakhor (1990) in Hidayah (2011) argue that a system based on shared ownership, such as the Islamic system, does not appear to be as vulnerable as an interest-based system from shocks that can result in a banking crisis.

In addition, PLS needs to be improved, such as asymmetric information and intensive monitoring. This concept is increasingly essential in Islamic banking because of the inherent risks such as agency risk (asymmetric information), financing risk, market risk, liquidity risk, operational risk, legal risk, reputation risk, strategic risk, compliance risk, return risk, and investment risk. Several previous studies have been conducted regarding mudharabah and musyarakah financing risks. Hennie Van Greuning and Zamir Iqbal in Islahi (2018) explained that PLS financing does have inherent risks from the contract model. Islamic banks must pay more than the results obtained from financed customers. Zamir Iqbal and Abbas Mirakhor in Ali (2019) explain that such a scheme differs from traditional banks that only face credit risk. Still, in the modern era, banking is open to various hazards caused by market uncertainty, financial innovation, and business shifts.

However, such an opinion is disputed since mudharabah practice can be found in the Prophet SAW and his Companions' traditions. In addition, banks can minimize possible losses by having direct and indirect control over the behavior of entrepreneurs through implicit and explicit contracts. Islamic banks can supervise them through formal contracts, a "stick and carrot" system, or rewards and punishments by refusing further credit or blocking dishonest entrepreneurs. The nature of this kind of contract allows the Bank to focus more attention on the possibility of business failure, the expected rate of return, promotion, and control over the companies where the Bank invests (Iqbal and Mirakhor, 1987 in Hidayah, 2011).

In addition to running a mudharabah and musyarakah financing, Islamic Bank offers Murabaha, a type of non-PLS financing. Murabahah is a contract of buying and selling objects by disclosing an acquisition price in the contract and adding its margin profit because, in Murabaha, it determines how much profit level is required (profit earned). Through murabahah financing, Islamic banks will profit from selling an item. In such a way, the Bank will get a profit margin equal to the agreed selling price of an item. Murabaha financing is currently the most favorable financing channel by Islamic banks. It has been contributed by its relatively low risk and definite return (Muhammad, Suluki, & Nugraheni, 2020). However, if the price of the asset acquired is high, murabahah also has a high risk (Zulvia & Nawirah, 2021). Therefore, the Bank must include additional items in the contract, such as collateral (Wulandari, Putri, Kassim, & Sulung, 2016).

Profitability will affect the company's performance in a better direction (Muhammad, 2005). Profitability is the skill of financial institutions to generate profits at the level of the performance of a financial institution, which is the goal of industrial management by optimizing stakeholder value, maximizing various levels of return, and minimizing the risks involved. The general analysis technique for assessing profitability is Return on Assets (ROA) which indicates how profitable a company is relative to its total assets. ROA provides an overview of how efficiently the management uses its assets to generate income. ROA is calculated based on comparing profit before tax and total assets. Banks with relatively large total assets will perform better because they have relatively large total revenues due to increased product sales (Devi & Firmansyah, 2018). Market share and concentration of Islamic banks positively affect changes in ROA levels (Abbas & Arizah, 2019).

Financing activities carried out by banks contain risks. The greater the financing disbursed, the greater the risk the Bank will face. This risk is a non-current financing payment known as Non-Performing Financing (NPF). NPF becomes a benchmark for banking performance and is one of the crucial indicators in measuring the Bank's soundness. So, all banks will continue to try to reduce this NPF figure, even if it is deemed necessary that the Bank not expand its financing if they do not have sufficient confidence in the prospect of the debtor being financed. NPF can occur due to inadequate credit ratings, weak anticipation of fewer prospective customers, and competition between Islamic banking and conventional financial institutions that have been doing business longer (Muhammad, 2005). This ratio continues to be significant until the quality of Islamic bank financing continues to be less good. The higher the Non-Performing Financing, the lower the profitability, and conversely, the lower the Non-Performing Financing, the higher the profitability.

HYPOTHESIS

The product based on Profit and Loss Sharing (PLS) are mudharabah and musyarakah financing. Mudharabah financing is a business cooperation agreement between the Bank as the owner of the funds (shahibul mal) and the Customer as the fund manager (mudharib) to run a business with a profit-sharing ratio by the agreement (Nabhaan, 2008). From the distributed mudharabah financing, the agreed profit-sharing ratio will be obtained. Profit sharing can be accepted if the fund manager maximizes the business's running properly and optimally. Meanwhile, musyarakah is a commercial cooperation agreement between several capital owners to include their capital in a business, where each party has the right to participate in implementing the company's management. Profits are divided according to equity participation proportion or mutual agreement (Yudiana, 2014). Musyarakah financing can involve several parties collected in a business or project. So, it is estimated that many entrepreneurs join musyarakah businesses based on Sharia principles.

The greater the PLS financing, the greater the profits obtained by the Bank (Kuswara et al. 2019; Masnah & Hendrawati, 2020). However, different results were found by Yusuf, Hamdani, & Kholik (2019) and Suwasdi, Hidayah & Nasution (2021), where PLS financing hurts the profitability of Islamic banks, meaning that mudharabah and musyarakah financing decreases the level of profitability. Therefore, the hypothesis to be tested in this study is:

H1: PLS financing has a positive and significant effect on the profitability of Islamic Rural Bank in Indonesia.

The product based on non-Profit and Loss Sharing (non-PLS) is murabahah, a contract of sale and purchase of objects with the right to the acquisition price and profit (margin) agreed upon between the seller and the buyer (Hidayah, Azis, & Muslim, 2022). This contract is a natural certainty because, in murabahah, it determines how much profit is required (Karim, 2014). The Bank buys goods from suppliers to meet customers' needs according to the desired specifications. Next, the Bank resells the goods to the Customer and makes a profit by increasing the purchase price according to the agreement between the Bank and the Customer. The Customer has options to make payments in cash or installments. The greater the distribution of murabahah financing provided by the Bank, the profitability obtained by the Bank will increase. A study by (Yusuf et al. 2019) found that non-PLS financing positively and significantly affects the Return on Assets. However, Dewantara & Bawono (2020) found that *non-PLS financing does not directly affect profitability.* This means that murabahah financing will lead to a decrease in the level of profitability generated by Islamic banks. Therefore, the hypothesis to be tested in this study is:

H2: non-PLS financing positively and significantly affects the profitability of IRBs in Indonesia.

In Islamic banking, the failure of installment payments, commonly known as NPF, will impact the Bank's profitability (Riyadi, 2017). Increased problems will lead to increasing NPF, so Islamic banks are wary of disbursing financing that potentially will decrease its profits. The higher the financing issued by Islamic banks, the higher the financing risk as measured by Non-Performing Financing (NPF). If the credit risk is high, the profitability will be low. This statement is in line with the research of Agustin et al.. (2018) and Masnah & Hendrawati (2020), which found that NPF from PLS financing has a significant negative effect on profitability (ROA). That means NPF can reduce the profitability of Sharia bank.

Conversely, Mulyaningsih & Fakhruddin (2016) state that the NPF from PLS financing significantly affects the profitability of Islamic commercial banks. This result shows that NPF does not reduce the ability to earn profits but, on the contrary, increases profits.

H3**:** PLS financing has a positive and significant effect on the probability of Islamic Rural Bank in Indonesia moderated by Non-Performing Financing (NPF)

Non-PLS financing (murabahah) has more certainty than PLS financing because the profit margin percentage is stated at the beginning of the contract, making the Bank ensure the profit obtained from that financing activities. In non-PLS financing, there is the possibility of buying and selling financing in installments. This, of course, can trigger the case of NPF, which will affect the performance of Islamic commercial banks in generating profits (profitability). Research by Masnah & Hendrawati (2020) states that non-PLS financing moderated by NPF positively and significantly affects profitability. That is, NPF strengthens the effect of murabahah financing on the profitability of Islamic Commercial Banks. In contrast, Pujiyanty et al.. (2022) state that non-PLS financing moderated by NPF negatively and significantly affects ROA in Islamic Commercial Bank in Indonesia.

H4: non-PLS financing has a positive and significant effect on the probability of Islamic Rural Bank in Indonesia moderated by Non-Performing Financing (NPF)

METHOD

This study aims to test the above hypotheses and asses the relationships between variables using a quantitative approach. The population of this study is the quarterly financial statements of Islamic Rural Banks (IRBs) taken from the financial statements of each Bank for the 2011-2020 period. Sampling was taken using the purposive sampling technique, one of the nonprobabilistic sampling techniques, which was carried out based on certain criteria adjusted for obtaining a representative sample per the needs of the research (Etikan, 2017).

The criteria for taking the sample that has been determined include: 1) IRBs registered with the Financial Services Authority; 2) IRBs that have published financial reports for the 2011-2020 period consistently; and 3) and have been published on the website of the Financial Services Authority. IRBs with the required data related to the variables used in this research are IRBs representatives from six provinces with consistent financial data at the Financial Services Authority.

Based on these criteria, it can be concluded that the samples in this study included IRBs Harta Insan Karimah (Banten Province), Amanah Ummah (West Java Province), Amanah Sejahtera (East Java Province), Investama Mega Bakti (Province South Sulawesi), Rahman Hijrah Agung (Nangroe Aceh Darrusalam Province), and Artha Amanah Ummat (Central Java Province). Research data was collected from the quarterly financial reports of IRBs in Indonesia for 2011–2020. Data regarding literature studies to strengthen research arguments were obtained from books, the internet, theses, and journals related to the discussion in this research.

The techniques used for data analysis are panel regression analysis because the data to be analyzed in this study has the form of time series data and cross-sections. With repeated observations of enough cross-sections, panel analysis permits the researcher to study the dynamics of change in short time series. Combining time series with cross-sections can enhance the quality and quantity of data in ways that would be impossible using only one of these two dimensions (Gujarati, 2003). Panel regression analysis aims to analyze the effect of PLS (mudharabah and musyarakah) and non-PLS (murabahah) financing on the profitability proxied by Return on Assets (ROA).

The authors also conduct a second test by inserting the Non-Performing Financing (NPF) variable as a moderating variable to see the effect of the relationship between PLS and non-PLS financing on ROA. Using Moderated Regression Analysis (MRA), a linear regression analysis technique determines the relationship between two variables influenced by the third or moderating variable. Gardner, Harris, Li, Kirkman, & Mathieu (2017) point out that there are three primary types of moderation effects: strengthening, weakening, and reversing effects. An interaction test was used in this study with the following equation (1) and (2).

$$ROA = \alpha + \beta 1 \text{Mudharabah} + \beta 2 \text{Musyarakah} + \beta 3 \text{Murabahah} + \epsilon \qquad (1)$$

$$ROA = \alpha + \beta 1Mudharabah + \beta 2\text{Musyarakah} + \beta 3\text{Murabahah} * \text{NPF} + \beta 4\text{Mudharabah} * \text{NPF} + \beta 5\text{Musyarakah} * \text{NPF} + \beta 6\text{Murabahah} + \epsilon \quad (2)$$

RESULTS AND DISCUSSION

Regression Test Results

The results of the study present several things that support the research objectives. Table 2. display an F-test that aims to see the effect of mudharabah, musyarakah, and murabahah on ROA simultaneously. Based on Table 2, the F-statistic result is 65.30494 with a significant level of 0.000000. So the financing of mudharabah, musyarakah, and murabahah has positively and significantly affected the ROA of IRBs in Indonesia for the 2011-2020 period. The adjusted R-squared is 0.812390. This means that mudharabah, musyarakah, and murabahah financing can affect the profitability variable, proxied by a ROA of 81.23%. Meanwhile, 18.76% can be influenced by other variables not examined in this study.

The T-test aims to see the effect of mudharabah, musyarakah, and murabahah on ROA partially, both before and after moderation by NPF. Table 3. shows that the calculated value of f (t-statistic) for mudharabah financing (X1) is 3.601999 with a probability of 0.0008, musyarakah financing (X2) is 5.058182 with a probability of 0.0002, and murabahah financing (X3) is 3.876453 with a probability of 0.0000 which is smaller than the value of a = 0.05. It means that mudharabah, musyarakah, and murabahah financing has positively and significantly affected the profitability of the IRBs in Indonesia from the 2011-2020 period. So, H1, H2, H3 is accepted. If mudharabah, musyarakah, and murabahah financing increases, then the profitability of the IRBs will also increase.

In the moderation test with the interaction test approach, the probability value M1 is 0.0005 < 0.05, and the calculated f value (t statistic) is -5.883022. The Prob value for M2 is 0.0003 <0.05, and the calculated f value (t-statistic) is -3.890492. So, the mudharabah and musyarakah negatively and significantly affect the probability of Islamic Rural Banks in Indonesia moderated by Non-Performing Financing (NPF). It means NPF weakens the effect of mudharabah and musyarakah funding on the profitability of the IRB in Indonesia from 2011-2020. So, H4 and H5 are rejected. Meanwhile, the Prob value for M3 is 0.0394 <0.05, and the calculated f value (t-statistic) is 7.432123. So, the murabahah has a positive and significant effect on the probability of Islamic Rural Banks in Indonesia moderated by Non-Performing Financing (NPF). It means NPF strengthens the effect of murabahah financing on the profitability of the IRBs in Indonesia from 2011-2020. So, H6 is accepted.

Table 3. shows that the level of profitability as proxied by ROA has a constant value of 0.041190. Based on these results, the equation obtained is (3) and (4):

$$ROA = 0.041190 + 0.050582\text{Mudharabah} + 0.065893\text{Musyarakah} + 0.076374\text{Murabahah} + \epsilon \quad (3)$$

$$ROA = 0.041190 + 0.050582\text{Mudharabah} + 0.065893\text{Musyarakah} + 0.076374\text{Murabahah} - 1.445678\text{MudharabahNPF} - 0.061345\text{MusyarakahNPF} + 0.051504\text{MurabahahNPF} + \epsilon \quad (4)$$

Table 2. F-test

F-statistic	65.30494
Prob(F-statistic)	0.000000
Adjusted R-squared	0.812390

Source: Eviews 9, Data Processed (2020)

Table 3. T-test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
(Constant)	0.041190	0.894020	0.967354	0.4678
Mudharabah	0.050582	0.672356	3.601999	0.0008
Musyarakah	0.065893	0.300922	5.058182	0.0211
Murabahah	0.076374	0.342098	3.876453	0.0000
MudharabahNPF	-1.445678	0.023100	-5.883022	0.0005
MusyarakahNPF	-0.061345	0.011123	-3.890492	0.0003
MurabahahNPF	0.051504	0.025116	7.432123	0.0394

Source: Eviews 9, Data Processed (2020)

Discussion

The Effect of PLS (Mudharabah and Musyarakah) Financing on Profitability (ROA)

This research results show that Profit and Loss Sharing/ PLS (mudharabah and musyarakah) financing has a positive and significant effect on the level of ROA at Islamic Rural Banks (IRBs) in Indonesia from 2011-2020. Each Bank is trying to raise and channel customer funds back to customers who need working capital. The profit sharing ratio or the profit of the PLS financing is uncertain because the Bank determines the profit sharing ratio by the business turnover obtained. Therefore, the income calculation constantly changes according to the achievement of business turnover. Similarly, the profit sharing on PLS financing provided by the Bank also fluctuates. The profit obtained by the IRBs increase the asset they have that will be channeled back for further financing, which can increase the profitability of the IRBs.

This result supports the previous research by Masnah & Hendrawati (2020) and Kuswara, Puji Lestari, & Retnaningsih (2019), which states that PLS financing positively and significantly affects profitability. However, this result does not support research by Yusuf et al.. (2019) and Suwasdi et al.. (2021), which found that PLS financing has not significantly affected the ROA of Islamic Banks, which means PLS financing does not increase the level of profitability of Islamic Banks. The banks are quite careful in financing the customers using PLS contracts because this scheme is relatively for long-term financing. Therefore, the results are expected to be long-term benefits. This means that PLS financing generates large profits in the long term and will significantly and consistently impact the banks' financial profitability for a long time. So, the IRBs carefully choose prospective customers, and the banks will only finance good business.

The Effect of non-PLS (Murabahah) Financing on Profitability (ROA)

Non-Profit and Loss Sharing/ non-PLS (murabahah) financing has a positive and significant effect on profitability as measured by the level of ROA at Islamic Rural Banks (IRB) in Indonesia from 2011-2020. From research on the financial statements of Islamic banks in Indonesia, it is known that most of the non-PLS financing issued by Islamic banks is five times higher than PLS financing. This is due to the low level of risk and definite return owned by non-PLS financing (Muhammad et al. 2020).

This result supports previous research by Yusuf et al. (2019) and Kuswara et al. (2019), which states that non-PLS (murabahah) financing positively affects profitability. However, this study challenges the study by Dewantara & Bawono (2020), who state that *non-PLS financing does not have a significant effect on the profitability of* Islamic commercial banks, where an increase in the volume of murabahah financing will lead to a decrease in the level of profitability generated by Islamic banks.

Non-PLS financing will affect the income earned by Islamic banks. Islamic banks will prefer the Non-PLS scheme with its nature of pre-determined profit and lesser risks to PLS schemes which are more costly and have higher risks. Perceived business practicality and product characteristics were considered significant from the customers' perspective (Wulandari et al. 2016).

The Effect of PLS (Mudharabah and Musyarakah) Financing on Profitability (ROA) with NPF as a Moderating Variable

This research found that Profit and Loss Sharing/ PLS (mudharabah and musyarakah) financing negatively and significantly affects the probability of Islamic Rural Banks in Indonesia moderated by Non-Performing Financing

(NPF). That means NPF weakens the effect of PLS financing on the profitability of the Islamic Rural Banks (IRB) in Indonesia from 2011-2020. PLS financing has a high level of risk, so the higher the NPF, the lower the ROA. The nature of PLS contracts may partly contribute to this. Especially for mudharabah formally does not require collateral. It also gives full rights to the mudharib to run the business without the intervention of the shahibul maal.

Furthermore, the financial Loss will be borne by the shahibul maal (except for management errors). These characteristics make the mudharabah financing scheme very vulnerable to risks, causing the possibility of PLS financing failure to be relatively higher. Asymmetric information on financing is one aspect that can cause the risk of moral hazard. Asymmetric information could occur because the Customer has more information on the financial data than the bank officers themselves. Customers, to make a deposit, dishonesty in the customer business reporting development use this information. These actions of the Customer, consisting of not providing the right report or the operation of keeping secret some aspects to the banks, are a form of moral hazard (Rodoni & Yaman, 2018).

Another factor that causes asymmetric information is that the banks do not perform oversight and monitoring of the development of the Customer's business. Although, in principle, the Bank cannot interfere with the Customer's business, the Bank is allowed to conduct supervision and guidance of the Customer's business to make sure that the PLS (especially in mudharabah financing) is not in a loss trend. In addition to worrying about the higher risk of return, Islamic financial inclusion, including Islamic banks, considered government regulation on PLS (mudharabah and musyarakah) to be tighter regarding provision and rescheduling (Yaya, Saud, Hassan, & Rashid, 2021).

This result supports previous research by Masnah & Hendrawati (2020), Hamdi., et al.. (2018), and Afkar (2018), who found that PLS financing moderated by NPF has a negative and significant effect on the profitability of Islamic Commercial Banks. The results indicate that NPF from PLS financing can reduce the profitability of Islamic Commercial Banks. However, this study challenges research by Mulyaningsih & Fakhruddin (2016), which showed that the NPF from musyarakah financing positively affects the profitability of Islamic banks, meaning that NPF does not reduce the ability to earn profits and even increases the profits.

One of the reasons why the PLS financing scheme is less attractive to Islamic banks is that the PLS-based financing model is relatively riskier because the level of return generated can be positive or negative, depending on the result of the business being financed. There may be an erosion of the principal value of the investment account when a loss occurs. As a result, depositors' funds were eroded, and Islamic banks finally hesitated to increase this financing model in the first stage of their operations.

NPF can be gradually resolved by intensifying the communication to the delinquent customers followed by restructuring the customers' financing policies. It also found that the strategies to reduce NPF ratios include improving bank risk financing management, upgrading the quality of human resources in risk management, and providing business mentoring and coaching to the customers. Islamic financial institutions, including BPRS, urgently need good financial risk management, particularly in monitoring the financed customers' business and in mitigating external conditions of the economy and their changing related regulations in order to settle the problem of non-performing finance and to strengthen their financial risk management (Hidayah & Tabrani, 2019).

The Effect of non-PLS (Murabahah) Financing on Profitability (ROA) with NPF as a Moderating Variable

The final finding in this research is that non-Profit and Loss Sharing/ non-PLS (murabahah) has a positive and significant effect on the probability of Islamic Rural Banks in Indonesia moderated by Non-Performing Financing (NPF). That means NPF strengthens the effect of non-PLS financing on the profitability of the IRBs in Indonesia from 2011-2020. Non-PLS financing has the least risk because it has an actual rate of return, both parties (financed Customer and Bank) must agree on the selling price and payment term, and the sale and purchase contract cannot be changed during the contract's validity (Khan & Ahmed, 2001). Non-PLS contracts are still dominant in Islamic banking operations: firstly, murabahah is a relatively easy short-term investment. Secondly, the profit derived from the markup can be determined and ensured. Finally, murabahah avoids uncertainty and minimizes the risks in the profit-sharing system.

This result supports previous research by Masnah & Hendrawati (2020), which showed that non-PLS (murabahah) financing moderated by NPF positively and significantly affects profitability. That means NPF strengthens the effect of non-PLS financing on profitability. The higher the ratio of the allocation of non-PLS financing to the allocation of profit-sharing financing, the lower the level of NPF in Islamic commercial banks. Islamic banks seem to rely more on non-PLS financing because monitoring the financed customers is less risky and relatively less costly. However, this result does not support Lusy Pujiyanti's (2022) research, which showed that non-PLS financing moderated by NPF negatively and significantly affects ROA in Islamic Bank in Indonesia.

In the current competitive banking business environment, Islamic banks will manage their financing schemes to maximize their profits while minimizing potential risks. Therefore, non-PLS schemes with pre-determined profit and lesser risks will be preferred by Islamic banks to PLS schemes which are more costly and have higher risks by nature.

CONCLUSION

The results showed that PLS (mudharabah and musyarakah) and non-PLS (murabahah) financing positively affected profitability as measured by the ROA of the Islamic Rural Banks (IRB) in Indonesia from 2011-2020. Non-PLS financing is generally in demand by customers to maximize the profits of the IRB. Non-Performing Financing (NPF), as a moderating variable, weakens the effect of PLS financing on the profitability of the IRB in Indonesia from 2011-2020. Meanwhile, as a moderating variable, NPF strengthens the effect of non-PLS financing on the Indonesian IRB profitability from 2011-2020. These findings explain why murabahah is still the dominant financing scheme in Islamic banking. However, Islamic banking should strive to achieve its ideal form as a profit-sharing financial intermediary to respond to the criticism that there is no substantial difference between Islamic and conventional banks as both rely on fixed returns in financing (margin) and lending (interest), considered similar to usury which is forbidden in Islam.

NPF will always overshadow the profitability of Islamic banks, especially in PLS financing, which has uncertain natures. Islamic Rural Banks (IRBs) need to consider financing risk management before providing financial assistance to customers, which includes fund management, portfolio management, SOP, and 5C analysis (character, capital, capacity, collateral, and conditions) to minimize business management negligence and risk of unexpected losses due to economic conditions or disasters. Islamic banks, especially IRBs, are expected to be able to balance profit-oriented commercial aspects with social aspects to achieve human-based economic development and social justice.

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