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The Impact of Financial Structure, Inflation, and Economical Growth on Non-performing Financing at Islamic Rural Bank in West Java 2011-2015

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This research was conducted to analyse the effect of financing structure seen from financing murabahah, financing mudharabah and musyarakah, inflation, and economic growth seen from gross regional domestic product against non-performing financing. This research used analysis regression panel data and processed using software eviews. The subject of this research is the Islamic Rural Bank in West Java with quarter periods in 2011 to 2015. The results showed independent variables had a simultaneous effect on non-performing financing; while with partial effect, appropriations financing murabahah, gross regional domestic product had significant negative influence on non-performing financing in Islamic Rural Bank West Java. The financing mudharabah and musyarakah, inflation had significant positive influence on non-performing financing of Islamic Rural Bank in West Java.

Key words: *Financial structure, Economic growth, Islamic rural bank, West Java.*

Introduction

Banking plays an essential role in improving the economy in Indonesia. Thus according to Antonio (2001:58), one of the main objectives of banks is to provide funding to fulfil the needs of those who suffer from deficit unit (Antonio, 2001). Budisantoso (2006:9) argued that banks function as agents of trust from the main foundation of their activities, whether in gathering funds or channelling them, and to pay back debt and other obligations when due. The second function is to act as agents of development and the third as agents of service. Services provided by banks are closely related to broader economic activities. These services



include transferring money, deposit of valuable goods, loans and completion of claims (Triandaru and Budisantoso, 2006).

This research uses four independent variables which are *murabahah* funding, *musyarakah and mudharabah* funding, inflation and economic growth. The aim is to examine specifically how the impacts of these four variables which is NPF that fluctuates. The object of this research is BPRS banks in West Java because the development of BPRS (number of banks, assets, funding, and NPF ratio) in the region is more dominant than the BPRS development in other regions.

The purposes of this research are the following: to test and analyse the simultaneous effect of *murabahah* funding, *mudharabah and musyarakah* funding, inflation, and economic growth to NPF in BPRS West Java region in 2011-2015. To analyse the partial effect of *murabahah* funding, *mudharabah and musyarakah* funding, inflation, and economic growth to NPF in BPRS West Java region in 2011-2015.

This research is expected to give benefits, information, and to add to the knowledge regarding sharia banking to Bank Indonesia, for academicians and for a broader audience. This study is expected to be used as a reference for future research.

Literature Basis

Sharia Funding Banks (Bank Pembiayaan Rakyat Syariah)

Indonesia, a country with the world's largest Muslim population, faces severe poverty problems. In 2014, over 28 million Indonesians lived below the poverty line, i.e. 11.3% of the population (Fianto et al. 2018). With the rise of the majority of Muslims in Indonesia, the development of sharia banking proved beneficial when tackling the 1997 economic crisis (Machmud and Rukmana, 2010:6). Business restrictions of BPRS were more assertively outlined in Article 27 of Bank of Indonesia Director Decree (SK Direktur BI) No. 32/26/KEP/DIR/1999. According to the decree as quoted by Sudarsono (2007:88), operational activities of BPRS are the following: (1) collecting funds from the people in form of savings; (2) channelling of funds; (3) other prevalent activities as done by a common BPRS as agreed by National Sharia Council (*Dewan Syariah Nasional*). Nowadays, in general level of efficiency sharia business unit Regional Development bank on the island of Java, has achieved good efficiency, although there are some banks and a few years yet to achieve efficiency (Cahyono and Laila, 2017).



Funding in Islam

The law of funding depends on the system used. If there is some kind of *riba'*, then the funding becomes *haram* (forbidden). On the contrary, if the funding is pure according to sharia law, then it becomes *halal* (allowed).

Landasan Hukum Islam tentang Pembiayaan

The Holy Qur'an *Surah Shad* verse 24 explains the responsibility in forming an alliance or cooperation. It is recommended not to cause any despotism to other people by requesting an extra from the profit gained. This verse also explains that Muslims who do not cause any harm in the cooperation with their partners are categorized as faithful and have done good deeds. Whereas *Surah An-Nisa* verse 58 explained the responsibility in delivering mandates.

Types of Funding

In providing funding, both parties (creditor and debtor) must establish trust between each other by saying "*I believe, I trust*". Wirdyaningsih (2005:131) divided the agreements or principles that underly operational fundings of BPRS into 5 groups: (a). Principles of Buying and Selling (*Ba'i*) including *Bai' al-Murabahah*, *Bai' as-salam*, and *Bai' al-Istishna*; (b). Principles of Lease (*Al-Ijarah*); (c). Profit Loss Sharing (*Syirkah*). *Al-Mudharabah Muthlaqah* and *Muqayyadah* (d). Principles of Loan. Meanwhile, the problems in implementing the *Salam* financing mechanism are no capital used as down payment in up front cash, and the risk of capital loss (Kurniawansyah and Agustia, 2017).

Functions of Funding

Providing funding with sharia principles that applies profit loss sharing in order not to incriminate the debtor is one of the advantages of sharia banking. According to Sumiyanto (2008:165), other functions of funding is to help poor people to avoid loan sharks by helping them through funding for their small businesses (Sumiyanto, 2008).

Purpose of Funding

BPRS are expected to increase the economic welfare of Muslims, adding jobs within districts, nurturing the spirit of *ukhuwah islamiyah* through economic activities that aim to increase income per capita and achieve better life quality.



Risks in Funding

A bank's loss will increase if the warranty of credit is not sufficient or cannot cover the funding given. Banks will experience difficulty if they are dealing with bad credit that is too large (Arifin, 2005).

7

Non-performing Financing (NPF)

In the statistics of sharia banking released by Bank of Indonesia Sharia Banking Directorate (*Direktorat Perbankan Syariah Bank Indonesia*), there is a term called *Non-performing Financing* (NPF) which is defined as non-good funding from "not so swift" to "bad" (Djamil, 2012). Funding given to clients is not free from the risk of NPF that affects the performance of sharia banks.

Murabahah Funding

In the technical aspects of banking, *murabahah* is a type of agreement of buying and selling between banks as the provider of goods and the customer who wishes to buy goods. Funding with *murabahah* agreement is the most common type used by banks due to certain characteristics, namely, certainty of instalment amount and the margin collected by sharia banks. Thus the management by sharia banks to debtors is easier.

Mudharabah and Musyarakah Funding (Profit Loss Sharing)

In other terms, profit sharing is the accumulation of net profit from total revenue after subtraction of expenses. According to Muhammad (2008:91) to reduce risk, sharia banks must diversify their risk. However, in PLS funding it is considered essential by sharia banks, especially to BPRS in long-term, that PLS funding will result in higher returns compared to other types of funding, with a better operational system that can reduce the risk of funding (Antonio, M. S., 2008).

Economic Growth

Regional GDP is an economic growth indicator in a specific region. It is an important measurement to describe the direct economic performance which is the performance of economic agents that provide goods and services including the banking industry. Yet an economy will not always grow, since in certain periods the economy will experience slow growth.



Effects of Murabahah Funding to NPF

In the funding structure, funding by *murabahah* agreement shows how large sharia banks place or split the funds channelled in *murabahah* funding by comparing the total funding channelled by sharia banks. The higher *murabahah* funding of the total funding channelled by sharia banks, the lower is the troubled funding in BPRS. This is because BPRS tends to focus more on *murabahah* funding due to the easier funding process and more supervision of *murabahah* debtors. The lower risk of *murabahah* compared to *mudharabah* or *musyarakah* and the return gained by banks make it more predictable. Hence the higher amount of *murabahah* funding resulted in lower sharia banking NPF. In the research by Kinasih (2013) and Ihsan (2011), it showed that RF has significant negative effects on NPF (Ihsan, 2011; Kinasih, 2013). But Nasution and Wiliasih (2007) concluded a different result – that RF has a significant positive effect on NPF. It argued that the increase in *murabahah* funding resulted in the increase of NPF (Nasution and Wiliasih, 2007).

Effects of Mudharabah and Musyarakah Funding (Profit Loss Sharing) to NPF

In the funding structure, funding with *mudharabah* and *musyarakah* agreement is a system that differentiates sharia banks from conventional banks, *mudharabah* and *musyarakah* funding is based on the principles of profit loss sharing, where profit obtained by *shahibul maal* (bank) is relatively unstable depending on the conditions of the businesses run by *mudharib* (debtor). Even banks must prepare to bear long-term risks of loss if the business run by the debtor is troubled. Hence, the operation is more oriented to businesses to avoid high NPF due to its influence on profit. In the end sharia banks are not paying attention to benefits of the *ummat* (people). A research by Susilawati (2011) showed that *mudharabah* and *musyarakah* funding has a significant effect on NPF. This result is supported by Khan and Ahmed (2001) who showed *mudharabah* and *musyarakah* funding has a higher credit risk compared to other types of funding (Khan and Ahmed, 2001). But Yasin (2014) argued that *mudharabah* and *musyarakah* funding has a negative significant influence to *Non-performing Financing*.

Effects of Inflation on NPF

Research by Kinasih (2013) showed a different result that inflation has a significant negative effect on NPF. When inflation occurs, the amount of return in sharia banking decreases. The decrease of funding outcome in sharia banking will increase the demand of funding. Funding for consumption with a low margin can increase buying power of sharia banking customers so that goods and services can flow in the economy and sales increase. This makes it easier for debtors to return the funding, so that NPF in sharia banking decreases. This is supported by Arijanto (2010:82) from the debtor side, which in this case are producers, that inflation



can have a good influence for producers if the return is higher than the increase in production costs. If this happens, producers will be encouraged to increase their production. This usually happens to large scale businesses so that debtors can have easier time paying back the funding.

Effects of Economic Growth on NPF

The higher the economic growth of a certain region, then it can be said that the particular region has a high prosperity level. The Regional GDP variable describes the economic condition of a region within a country.

Research Hypotheses

To understand the effects of *murabahah* funding, *mudharabah* and *musyarakah* funding, inflation, and economic growth, this research proposes the following hypotheses:

H1: *Murabahah* funding, *mudharabah* and *musyarakah* funding, inflation, and economic growth have significant effects on Non-performing Financing (NPF) in BPRS in West Java during 2011-2015.

H2: *Murabahah* funding has a significant effect on NPF in BPRS in West Java during 2011-2015.

H3: *Mudharabah* and *Musyarakah* funding has a significant effect on NPF in BPRS in West Java during 2011-2015.

H4: Inflation has a significant effect on NPF in BPRS in West Java during 2011-2015.

H5: Regional GDP has a significant effect on NPF in BPRS in West Java during 2011-2015.

Methods

This research is using the quantitative research approach. While dependent variables are variables that is affected or become an effect of independent variables. The independent variables (X) of this research are the following: (1) *Murabahah* Funding (X1); (2) *Mudharabah* and *Musyarakah* (PLS) (X2); (3) Inflation (X3); (4) Regional GDP (X4). b. The dependent variables (Y) of this research are the following *Non-performing Financing* (Y). The data used in this research are obtained from secondary sources. The secondary data gathered are processed primary data. This research uses multiple regression analysis with panel data as the data processing tool using Eviews 7. The combination of two types of data shows that the dependent variable *Non-performing Financing* (NPF) is a cross-section of a few units of BPRS in West Java and within the period between years 2011-2015 (time series).



Results and Discussion

The subject of this research is *murabahah* funding, *mudharabah* and *musyarakah* funding, inflation, regional GDP and Non-performing Financing. While the objects of this research are BPRS offices in West Java, from 29 BPRS in West Java spread in 27 cities/regencies, this research used 7 BPRS in West Java.

The data required for the research results are sourced from sharia banking statistics available at the Financial Services Authority website and regional economic and finance studies in the Bank of Indonesia website.

According to Bank of Indonesia, Non-performing Loan (NPL) or Non-performing Financing (NPF) refers to troubled credits consisting of credits classified as “non current”, “doubted”, and “jammed.” During 2011 until 2015, 2012 was the only year of the lowest amount was 5.20%. The NPF level in BPRS in West Java also showed it exceeding the NPF limit set by the Bank of Indonesia; the highest ratio, which was 7.95%, happened in 2014. *Murabahah* funding data used in this research are the BPRS *murabahah* funding in West Java every quarter during 2011 until 2015. Until 2015, *murabahah* funding was at 4,443,955,000 Rupiahs channelled for the needs of the people.

Description of *Mudharabah* and *Musyarakah* Funding of BPRS

Mudharabah and *Musyarakah* are the agreement that has a profit loss sharing system where, in doing economic activities, both parties will be tied to a contract where in the business if there is a profit, then it will be shared to both parties according to the agreement. Conversely if there is a loss, then it will be the responsibility of both parties accordingly. *Mudharabah* and *Musyarakah* funding is increased every year; this also shows that the functions of BPRS are well run to channel funding especially in *mudharabah* and *musyarakah* agreements. The total amount of *mudharabah* and *musyarakah* funding was at the highest point in 2015 with total of 820.832.000 Rupiahs. Yet the development of *mudharabah* and *musyarakah* funding is not as much of *murabahah*; this happens because of the agreement chosen between banks and debtors.

Discussion

With significance rate of 0.05, and simultaneously the probability of F test is 0.000000 which is lower than the significance rate. This explains that *murabahah* funding, *mudharabah* and *musyarakah* funding, inflation, and regional GDP simultaneously have significant effects on Non-performing Financing of BPRS in West Java. It can be concluded that the hypothesis accepted is H1. This result is aligned with the research by Yasin (2014) that stated



mudharabah and musyarakah, inflation, Gross Domestic Product have significant effects on NPF.

It can be concluded that the hypothesis decision is to accept H2. This is corresponding to the research by Ihsan (2011) and Kinasih (2013) that stated murabahah funding has a negative significant effect on Non-performing Financing. But the advantage of murabahah agreement is lower risk of troubled funding.

Based on the analysis of this research, the variables mudharabah and musyarakah funding have a positive effect on Non-performing Financing. Partially, the t-statistics test showed that mudharabah and musyarakah funding has a significant effect on Non-performing Financing. The variables mudharabah and musyarakah funding affects Non-performing Financing positively with a coefficient level of 0.102552 and probability of 0.0166. Thus if mudharabah and musyarakah funding increases, Non-performing Financing will also increase.

It can be concluded that the hypothesis decision is to accept H3. Mudharabah and Musyarakah funding is a type of funding that differentiates sharia banking from conventional banking in terms of the system due to the profit loss sharing principle. In BPRS, mudharabah and musyarakah funding executed between years 2011-2015 was only 14% of total funding channelled by BPRS. It must be done as based on the statistics data of sharia banking in December 2015, BPRS granted higher funding for small businesses than non-small business sector that showed mudharabah and musyarakah funding is necessary for small businesses to increase their performance and eventually improve a regional economy.

It can be concluded that the hypothesis decision is to accept H4. This corresponds with researches by Skarica (2013), Rahmawulan (2008), and Yasin (2014) that argued inflation has a significant positive effect on Non-performing Financing.

Based on the statistical analysis in this research, the regional GDP variable affects Non-performing Financing negatively. Partially, t-statistics test showed that regional GDP has a significant effect on Non-performing Financing. Regional GDP has a negative effect toward Non-performing Financing with a coefficient level of -1,758292 and probability of 0.0001. Thus if economic growth is declining, then Non-performing Financing will rise.

It can be concluded that the hypothesis decision is to accept H5. This is proven by the regional GDP graph in West Java that experienced decline at the end of 2015 followed by the increase of Non-performing Financing as illustrated in Picture 4.1 in 2015 that showed regional GDP has a negative impact towards Non-performing Financing in BPRS in West Java.



Conclusion

Based on the output of F statistics, murabahah funding, mudharabah and musyarakah funding, inflation, and regional GDP all simultaneously have significant effects towards Non-performing Financing (NPF) for BPRS in West Java during 2011-2015 with panel data regression equation results as follows: $NPF = 20.61752 - 0.075362(MUR) + 0.102552(PLS) + 0.305025(INF) - 1.758292 (GDP)$. Based on the output of t-statistics test, murabahah funding has a partial negative significant impact on Non-performing Financing on BPRS in West Java during 2011-2015 with regression coefficient of -0.075362 and probability of 0.0244. This result shows that the decrease of funding channelled by BPRS in West Java during the period 2011-2015 will increase NPF ratio of BPRS in West Java. Based on the output of t-statistics test, mudharabah and musyarakah funding has a partial positive significant impact on Non-performing Financing on BPRS in West Java during 2011-2015 with regression coefficient of 0.102552 and probability of 0.0166. This result shows that the increase of funding channelled by BPRS in West Java during the period 2011-2015 will increase NPF ratio of BPRS in West Java.

This results shows that the rise of inflation in West Java during the years 2011-2015 will increase the NPF ratio of BPRS in West Java. Based on the output of t-statistics test, regional GDP has a partial negative significant impact on Non-performing Financing on BPRS in West Java during 2011-2015 with regression coefficient of -1.758292 and probability of 0.0001. This result shows that if regional GDP is decreasing the economic conditions in West Java are poor during 2011-2015. Thus, it will increase Non-performing Financing of BPRS in West Java.



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PAGE 1

PAGE 2

PAGE 3

PAGE 4

PAGE 5

PAGE 6

PAGE 7

PAGE 8

PAGE 9

PAGE 10
