Islamic Banking Performance Analysis: Risk and Return Approach

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Abstract

Financing is the main activity of Sharia banking which is faced with two conditions of risk and return. The composition of financing in Islamic banking gives a tendency to finance with the principle of sale and purchase, especially murabaha, dominating more financing products than financing with the principle of profit sharing reaching 61% of the total financing disbursed. Research shows that three out of a total of Fourteen Sharia Commercial Banks show that profit sharing financing dominates the financing products distributed the rest is dominated by sale and purchase financing. In conclusion, the existence of financing risk or Non-Performing Financing (NPF) is the main factor that concerns the banking sector in channeling financing. Meanwhile, Return is inversely proportional to Risk.

Keywords: Financing, Return, Risk, Sharia Banking

A. Introduction

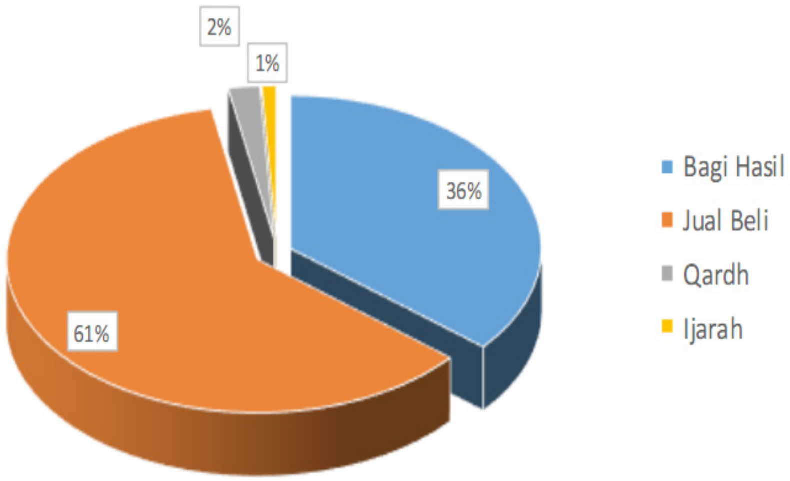
According to Law No. 21 of 2008, the Shariah Bank is a Bank that conducts its business activities based on Shariah principles and of its kind consisting of the Shariah General Bank and the Shariah Rural Bank. Shariah General Bank is a Shariah Bank in which it provides services in payment traffic.

The Act encourages the rapid development of Sharia banking in Indonesia as evidenced by the broad network of Sharia banking offices. Based on Sharia banking statistical data in June 2019 there were 14 Sharia Commercial Banks, 22 Sharia Business Units and 164 Sharia Rural Banking (http://www.ojk.go.id).

Islamic banks have several products in carrying out their duties as intermediary institutions between people who are overfunded and those who are underfunded. One of them is profit sharing based financing products. Profit sharing financing is carried out using mudharabah and musyarakah contracts. In practice financing murabaha principle of trading mainly dominates finance products compared to financing with the principle of sharing around 61% of total financing disbursed.

The profit sharing financing pattern is more suitable to activate the real sector because it covers the possibility of channeling funds to consumptive interests and to productive business interests. This is an interesting phenomenon because it is expected that financing with profit sharing principles dominates the financing products distributed. The following is the composition of financing channeled to Islamic Commercial Banks in Indonesia.

Figure 1 Composition of Financing at Islamic Commercial Bank



Source: Sharia Banking Statistics, June 2019

Financing risk or Non-Performing Financing (NPF) is the main factor that becomes the concern of banks in financing. The more funds channeled, the greater the potential for risk arising. Funding with profit sharing pattern is considered high risk. This is what then causes financing with revenue sharing patterns to be avoided. The higher NPF in the previous year will reduce the composition of profit sharing financing at this time.

Andraeny's research (2011) show that variable third party funds, profit sharing rates and non-performing financing in Islamic banking in Indonesia. The results indicate that third party funds and profit sharing levels have a significant effect on the volume of profit sharing based financing. In contrast to non-performing financing which states the results do not have a significant effect on the volume of profit-sharing based financing.

The same results Wahab's research (2014) show that the variables FDR, NPF, the level of profit sharing, service quality and attributes of Islamic products in Islamic Commercial Banks in Semarng. The results show that the quality of services and attributes of Islamic products affect mudharabah financing. In contrast to FDR, the profit sharing rate and NPF that show results have no effect.

Meanwhile, the results of Giannini's (2013) research with FDR, NPF, ROA, CAR and profit sharing variables, stated that non-performing financing had no effect on mudharabah financing. The three research results above show that non-performing financing has no effect. This means that the level of non-performing financing does not affect the bank's decision to distribute profit-sharing financing. These results are different when viewed from normative and empirical aspects which state that profit sharing financing is vulnerable to risk.

In addition to risk factors, other factors that also need to be considered in channeling financing are profit factors. Return on profit sharing financing is income obtained by banks for the distribution of profit-based financing. Whereas the sale and purchase financing return is obtained from income from distribution of sale and purchase financing. The greater the amount of funding provided, it is expected that banks will get high returns (Wangsawidjaja, 2012).

Research by Wulandari, et al (2013) uses the profit sharing variable against profit sharing financing. The results show that profit sharing affects the profit sharing financing. Where the greater the profit-sharing financing distributed, the higher the return obtained. And the higher return obtained in the previous year will encourage banks to increase profit-based financing at this time.

Return on profit sharing financing containing uncertainty. Return on sale-based financing in the form of margin is determined in such a way as to ensure that the bank can benefit. Murabaha removes the uncertainty that exists in income from businesses with a profit sharing system.

This research is interesting because the research specifically compares the profit sharing financing and sale and purchase financing by using each financing by paying attention to the aspects of risk and profit.

B. Islamic Banking and Characteristics of Financing

Based on Law Number 21 Year 2008, Sharia Banks are Banks that carry out their business activities based on Sharia principles and by type consist of Sharia Commercial Banks and Sharia People Financing Banks. Sharia Commercial Bank is a Sharia Bank which in its activities provides services in payment traffic.

Islamic banks act as an intermediary institution between people who are overfunded and those who are short of funds. Banking moves through fund raising activities before then channeling the funds back to those in need.

Islamic banks with their operational characteristics and principles that are different from conventional banking institutions can demonstrate and play a greater role in the effort to empower micro, small and medium business groups while still referring to the principle of prudence and several other important matters.

According to Rivai, et al (2008) The concept of Islamic bank financing is divided into four namely:

1. Profit and Loss Sharing

   The concept of profit sharing financing is a concept of financing that is fair and has a strong partnership feel. Profit sharing financing is applied based on mudharabah and musharaka principles.
2. Sale and Purcashe Financing System

   The concept of financing where the agreed price will not change until the end of the contract. The financing of the sale and purchase is applied to the products of bai'u murabahah, bai'u salam, bai'u istishna '.
3. Lease Financing System

   Transfer of use rights (benefits) of an item or service within a certain time through lease payments. Lease finance is divided into two types of pure ijarah products and ijarah al muntahiya bit tamlik.
4. Other Financing Systems

   Unlike the financing group with the pattern above, in other financing there is no element of goods as an object of financing and therefore more an object of transaction. Even if there is an element of goods it functions as collateral. These products are hawalah and rahn.

C. Sharia Banking Financing and Risks

Financing risk can be measured using the Non Performing Financing (NPF) ratio. NPF is the ratio between problematic financing and total financing channeled. This financing risk arises when unable to recover bills on loans or investments that are being done (Muhammad, 2002).

The occurrence of bad loans can threaten the smooth flow of funds. If that happens, the Bank will not be able to fulfill the obligation to provide funds. That is because funds embedded in bad loans cannot be withdrawn anymore (Haris, 2013). The amount of funds channeled is highly dependent on the magnitude of the risk borne by Islamic financial institutions.

The classification of financing is carried out in order to facilitate the mapping of types of financing. In general, the classification of financing is divided into four categories namely current, substandard, doubtful and loss. Categories included in problem financing are substandard, doubtful and loss financing.

The impact of the high NPF (Non Performing Financing) causes a decrease in capital (Wahyudi, 2013). Hakim, et al (2008) showed that the relationship between bad credit (NPF) and financing offer was negative. The higher the bad credit will cause a decrease in credit supply.

Risk of Profit Sharing Financing

Non Performing Financing (NPF) is the ratio between problematic financing and total financing channeled. This financing risk arises when unable to recover bills for loans.

The occurrence of bad loans can threaten the smooth flow of funds. If that happens, the Bank will not be able to fulfill the obligation to provide funds. That is because funds embedded in bad loans cannot be withdrawn anymore. The amount of funds channeled is very dependent on the magnitude of the risk borne by Islamic financial institutions (Wiroso, 2005).

According to Muslehuddin (1994), Financing with mudharabah and musyarakah contracts has the highest liquidity risk. Mudharabah is fraught with risks, if mudharib acts dishonestly or deceitfully. The risk will multiply if plunged into this burden.

Mudharabah and musyarakah are profit and loss sharing agreements and face the risk of capital loss even with adequate supervision. The level of risk is relatively higher compared to other investments and institutions must be very careful in evaluating and selecting projects to reduce potential losses (Rustam, 2013)

Risk of Sale and Purchase Financing

Non Performing Financing (NPF) is the ratio between problematic financing and total financing channeled. This financing risk arises when unable to recover bills for loans.

The occurrence of bad loans can threaten the smooth flow of funds. If that happens, the Bank will not be able to fulfill the obligation to provide funds. That is because funds that are embedded in bad loans cannot pulled again. The amount of funds channeled is highly dependent on the magnitude of the risk borne by Islamic financial institutions.

The Murabahah financing mechanism does not allow Islamic banks to interfere in business management because they are not partners with clients but their relationship is the relationship between creditors and debtors. Murabaha faces the risk of client failure to pay back. In regards to salam and istishna the risk is added with the risk of failure to deliver goods and the risk of falling prices (Rivai, et al, 2013)

D. Sharia Banking Financing and Returns

Return or Revenue is defined as gross increase in assets or a combination of both, this income is obtained from halal investment, trading or selling goods, selling services, or other activities aimed at obtaining profits for the company. In accordance with the funding distribution agreement in a Sharia bank, the results of the fund channeling can provide income for the bank.

According to Aziz (2010), income from fund distribution activities carried out by Islamic banks is referred to as main operating income, which is revenue to be collected, revenue which is an element of profit sharing. Income for banks is the most important because bank income can guarantee the continuity of the bank concerned, can pay dividends for bank shareholders, increase employee compensation, is a benchmark for the soundness of the bank and is a benchmark of good or bad bank management. In addition, revenue can also increase the competitiveness of the bank concerned, increase public confidence in the bank and improve the status of the bank concerned (Haris, 2013)

The greater the amount of funding provided, it is expected that banks expect high returns as well. The loss of the opportunity to earn income (income) from financing reduces profits and adversely affects rentability, Islamic banks will be more careful with reducing financing.

Return on Profit Sharing Funding

Sources of income of Islamic banks can be obtained from profit sharing. Revenue sharing consists of fund distribution transactions based on the mudharabah mutlaqah and musyarakah principles. Profit sharing income is recognized when the bank receives periodic reports on businesses that have been carried out by mudharib or fund or business managers. Revenue sharing is reduced by losses arising from mudharabah and musyarakah financing.

The distribution of funds based on the mudharabah and musharaka syirkah contracts has two sides of a coin that have the potential to generate profits and cause losses. Syirkah because it is based on profit sharing based on investment performance means that there is a possibility that profit sharing cannot be given if it turns out that the channeled investment ends in loss

Realization of profit sharing in the syirkah contract, namely mudharabah and musyarakah, is very flexible following market dynamics. When the market is good and growing, the bank will get greater returns, and so will the customers. Conversely, when business conditions are sluggish and stagnant, even negative, banks will transfer the risk to customers.

According to Aisyah (2015) the factors that influence the profit sharing are divided into two factors, namely direct and indirect.

1) Direct Factors

   The direct factors affecting the profit sharing calculation are the investment rate, the amount of funds available, and the profit sharing ratio

   a. Investment rate is the actual percentage of funds invested from total funds

b. Amount of funds available for investment
c. Ratio must be determined and agreed at the beginning of the agreement.

2) Indirect Factor
a. Determination of items of income and mudharabah costs
b. The profit-sharing accounting policy is indirectly affected by the running of activities implemented primarily in relation to revenue and cost recognition.

In the profit-sharing financing scheme the bank accepts the possibility of lower revenue-sharing revenue as well as the opportunity to get a higher profit-sharing than projected (Laksamana, 2009). The higher the customer's business performance, the higher the profit sharing for each party.

Return on Sale and Purchase Financing

The distribution of funds will be obtained income which in the principle of sale and purchase is commonly referred to as margin or profit. Income from the distribution of funds is called the main operating income, because it is income that will be shared or income which is an element of the distribution of business results which will then be shared with the owner of the fund and fund manager.

Buy and sell financing, generally murabaha is widely used as the main financing model with a number of reasons including aspects of profit. The mark-up in murabaha can be determined in such a way as to ensure that the bank can make a profit comparable to the profit of interest-based banks that rival Sharia banks, murabaha removes the uncertainty that exists in income from businesses with profit sharing systems.

This is as according to Wiroso (2005) which states that in murabaha transactions, bank revenue can be predicted Sharia banks can already estimate the income to be received, because in murabahah transactions the customer's debt is the selling price of the principal portion and profit portion. So that in normal circumstances the bank can predict the income to be received.

In addition, avoidance of uncertainties inherent in business acquisition based on the PLS system. This then becomes one of the banks' preferences in channeling murabaha financing with a larger portion.

E. Conclusion

Financing in Islamic Banking is faced with two risks and risk or income or return. According to financial theory, the higher the profit, the higher the risk faced. This shows that high profit expectations are offset by consequences for large risks, and vice versa. Profit sharing financing and sale and purchase financing have different characteristics. This is a consideration for banks in channeling financing.

Risk and return are no exception to consideration. Based on data from the Financial Services Authority (June, 2019) it is known that sale and purchase financing dominates the distribution of Sharia banking financing reaching 61 percent. The following is the distribution of profit sharing financing and sale and purchase financing at Islamic Commercial Banks in Indonesia. Sharia banking preferences on financing with the principle of buying and selling. Only a few banks put financing with the profit sharing principle as the main financing. Three of the total of Eleven Sharia Commercial Banks show that profit sharing financing dominates the financing products distributed the rest is dominated by sale and purchase financing. This shows that the Risk Asek is the main concern in the distribution of sale and purchase financing compared to the high return offer from profit sharing financing.

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