Research Article

Profit And Loss Sharing System and Profitability of Islamic Rural Bank in East Jawa Indonesia

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ABSTRACT: This study aims to analyze, prove and find; (a) the effect of the profit sharing system on the risk of islamic rural banks; (b) the effect of the profit sharing system on efficiency of the islamic rural banks; (c) the effect of efficiency on risk of the islamic rural bank; (d) the effect of the profit sharing system on the profitability of the islamic rural banks; (e) the effect of risk on the profitability of islamic rural bank and (f) the effect of efficiency on the profitability of an islamic rural bank. This research is included in the type of explanatory research . This study uses path analysis with the SPSS program to test, analyze and prove the relationship of the influence of independent variables that affect the profitability of the islamic rural banks. This study found that (a) profit sharing system has no significant effect on the risk of the islamic rural banks; (b) the profit sharing system has a significant effect on the efficiency of the islamic rural banks; (c) efficiency has a significant effect on the risk of islamic rural banks; (d) the profit sharing system has no significant effect on profitability of the islamic rural banks; (e) the risk has a significant effect on the profitability of the islamic rural banks and (f) efficiency has a significant effect on the profitability of an islamic rural bank (IRB);.

Keywords: Profit Sharing System, Efficiency, Risk, Profitability, Islamic Rural Bank

Background

Hassoune (2002) proves that the profitability of islamic banks is better than conventional banks. This is because the influence of leveling comes from the ability of Islamic banks to absorb surprises on asset income through a system of profit and loss sharing. This profit sharing system plays a role as a cushion, or insurance against the returnability of the return, in which conventional banks cannot do this because they have to pay interest, this is less flexible. This is supported by Andrew (2005) found that Islamic banks in Egypt are very efficient and profitable. According to Ariff (1988) profit sharing systems can help allocate resources efficiently, because the profit sharing ratio can be influenced by market forces so that capital will flow to sectors that offer the highest profit sharing ratio to investors. The profit sharing ratio varies between banks and time depending on the conditions of supply and demand. In theory, the level of income can be positive and negative, but in practice Islamic bank returns are always positive and competitive compared to the interest rates of conventional bank deposits.

According to Hassoune (2002) the main reason is that there are differences where Islamic banks are more fortunate because of market imperfections, namely the availability of non-remunerated deposits in large amounts, thereby reducing funding costs. El-Biraika (1998) explains that the profit sharing system improves finance stability through risk reduction and eliminates conflicts of interest between borrowers and lenders, making Islamic banking more efficient as an intermediary institution. However, according to Kazmi (2004) states that the risk of economic losses is greater in Islamic banks because the weak investment decisions will not

only cause a decrease in the value of the storage assets but also reduce the bank's profits.

Theoretically Islamic banks face two risks, namely moral risk because of the low honesty and integrity of some borrowers in delivering losses, and business risks that come from unexpected market behavior (Kazmi 2004). In mudaraba contracts and musyarakah uncertainty is very high level of capital income due to information asymmetry which creates moral hazard and adverse selection problems. Islamic banks will face difficulties due to limited information on project quality. The Borrower has inside information about the manager's activities and the likelihood of success of the project cannot be shown to the bank correctly because each borrower will say the quality of the project is higher (Edwardes:1999). Although the islamic bank is profitable in terms of profitability, it is not a panacea for banking players in the Islamic world, because they are limited by a number of weaknesses that often occur especially with regard to liquidity, risk of concentration and operational efficiency (Sarker: 2002).

Yulinartati, Roziq and Norita (2015) conclude that some of the shortcomings of financing profit sharing schemes to micro, small and medium enterprises are compared to financing murabahah schemes or non-profit and loss sharing schemes including; (a) the presence of inequality of perception between customers and banks; (b) weakness of customers in preparing financial statements; (c) financial recording is still manual; (d) schemes of profit and loss sharing systems require an orderly system; (e) reporting of non-objective profits from micro, small and medium enterprises; (f) the transaction murabahah is easier/clearer. Some difficulties or constraints faced and felt

by micro, small and medium enterprises related to profit sharing system obtained from financial institutions consits of; (a) difficult administrative requirements; (b) no credit guarantees; (c) insufficient amount of credit guarantees; (d) high profit sharing costs; (e) refund period in oneyear; (f) difficulty in determining profit sharing because they have not been able to compile financial statements, (g) difficulty in understanding the characteristics of partners, (h) loss insurance problems, (i) lack of understanding of sharia patterns. This study aims to analyze, prove and find (a) the effect of the profit sharing system on the risk of islamic rural banks; (b) the effect of the profit sharing system on efficiency of the islamic rural banks; (c) the effect of efficiency on risk of the islamic rural bank; (d) the effect of the profit sharing system on the profitability of the islamic rural banks; (e) the effect of risk on the profitability of islamic rural bank and (f) the effect of efficiency on the profitability of an islamic rural bank.

Literature Review

Sharia Enterprise Theory

Sharia enterprise theory is an enterprise theory that has been internalized with islamic values in order to produce a transcendental and more humanistic theory. According to Triyuwono (2007: 4), enterprise theory is a theory that recognizes accountability not only to the owner of the company but to a wider group of stakeholders. Enterprise theory was later developed so that the theory is closer to the concept of sharia so that a theory is formed which is known as the sharia enterprise theory. According to Triyuwono (2007: 4), sharia enterprise theory explains that stakeholders consist of God, nature and humans and the highest stakeholder is God as the center.

Islamic Rural Bank

Islamic rural bank use sharia principles in conducting business, it is further regulated according to the Decree of the Director of Bank Indonesia No. 32/36 / KEP / DIR / 1999 dated May 12, 1999 concerning Sharia Rural Banks. In this case, Islamic rural bank can technically be interpreted as financial institutions same with conventional rural bank, whose operations use islamic principles. The desired objectives with the establishment of islamic rural banks are:

a. improving the economic welfare of muslims, especially the poor who are generally in rural areas;

b. increase employment, especially at the sub-district level, so as to reduce the flow of urbanization;

c. fostering the spirit of Islamic brotherhood through economic activities in order to increase per capita income towards an adequate quality of life.

Research Method

This research is included in the type of explanatory research because it explains causal relationships between variables through testing hypotheses. The type of data used in this study is secondary data. Secondary data is the financial statements of the sharia rural banks period of year of 2014-2017 obtained from the Directory of the Indonesian Financial Services Authority. The population number of this study were 29 sharia rural banks (Statistics of the Indonesian Financial Services Authority, 2018). While the sample in this study is the sharia rural bank which has published and announced the financial statements from 2014 to 2017. The sample size according to Hair et al (1998) suggests that the minimum sample size is 5 to 10 times the number of independent variables used in research. Data collection procedures using documentation-archive techniques. Documentation-archive techniques will produce data in the form of financial ratios derived from income statement and financial position during 2014 to 2017. The analytical technique in this study uses quantitative analyzes. Quantitative analysis used in this study consisted of descriptive analysis to see the description of population characteristics and path analysis.

Path analysis is the relationship between independent variables, intermediate variables, and dependent variables which are usually presented in the form of diagrams. Path analysis is used to analyze the pattern of relationships between variables in order to determine the direct or indirect effects of a set of independent (exogenous) variables on the dependent variable (endogenous). The following is a research conceptual framework that summarizes the relationship of independent variables, intermediate variables, and dependent variables which are usually presented in the form of path diagram (as mentioned in figure 1) that will be analyzed by path analysis.
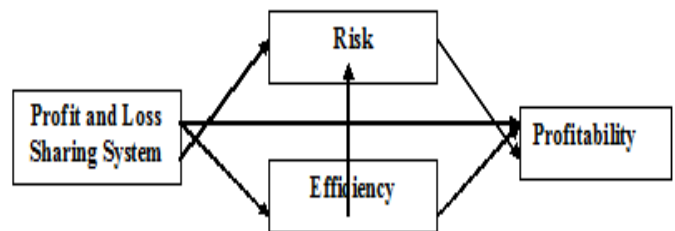

Figure 1. Framework Conceptual of Research

Results and Discussion

Data normality test aims to determine whether the residual variable has a normal distribution. Based on the results of normality testing, it can be seen that the probability or significance value is the profit sharing system variable of 0.657, the risk variable is 0.091, the efficiency variable is 0.994 and the profitability variable is 0.731. This value is greater than 0.05. so, it can be stated that the data in this study are normally distributed. Multicollinearity test aims to determine whether the regression model found a correlation between independent variables (Ghozali, 2011: 105). Based on the results of the collinearity statistics analysis, it is known that the model does not occur multicollinearity. This is indicated by the VIF value of each variable less than 10 and the tolerance value of more than 0.10.

Heteroscedasticity test aims to test whether in the regression model there is a variance inequality from residuals one observation to another observation Heteroscedasticity test results show that the significance value of the 0.510 glacier test exceeds 0.05. So it can be stated that there is no

heteroscedasticity. The autocorrelation test aims to test whether in the linear regression model there is a correlation between the interfering error in period t with the confounding error in the period t-1 (before). The result of autocorrelation test using run-Test shows that the significance value of the run test is 0.106 exceeding 0.05. So that it can be stated that the data in this study there is no autocorrelation.

Path analysis is an extension of multiple linear regression analysis, or path analysis is the expansion of regression analysis to estimate the relationship between variables that have been predetermined based on theory (Ghozali, 2011). Path analysis is used to analyze the pattern of relationships between variables in order to determine the direct or indirect effects of a set of independent (exogenous) variables on the dependent variable (endogenous).

Table 1. Path Analysis Test Results

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.522	.367		4.145	.000
LNSBH	-.019	.016	-.118	-1.219	.226

Source: SPSS Output

Based on the results of path analysis test shown in table 1, it is known that the significance value is 0.226 (not significant). This shows that the profit and loss sharing system measured by profit and loss sharing financing has no significant effect on financing risk. Based on the results of the path analysis test, it is known that the research equation in the form of regression models is as follows.

$Y = 1{,}522 - 0{,}019\ X_1$

Y = risk

X_1 = profit and loss sharing system

Table 2. Path Analysis Test Results

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-2.763	1.148		-2.405	.018
LNSBH	.184	.049	.342	3.725	.000

Source: SPSS Output

Based on the results of the path analysis test shown in table 2, it is known that the significance value is 0,000. This shows that the profit and loss sharing system as measured by profit and loss sharing financing has a significant effect on efficiency as measured by total mudharabah and musyarakah financing divided by total mudharabah fund pooling. Based on the results of the path analysis test it is known that the research conditions in the form of regression models are as follows.

$Y = -2{,}763 + 0{,}184\ X_1$

Y = efficiency

X_1 = profit and loss sharing system

Table 3. Path Analysis Test Results

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.941	.046		20.372	.000
1 INVEFI	.089	.028	.293	3.142	.002

Source: SPSS Output

Based on the results of the path analysis test shown in table 3, it is known that the significance value is 0.002 (significant). This shows that the efficiency measured by total mudharabah and musyarakah finanacing divided by total mudharabah fund pooling has a significant effect on financing risk. Based on the results of the path analysis test, it is known that the research model in the form of a regression model is as follows.

$Y = 0{,}941 + 0{,}089\ X_1$

Y = risk

X_1 = efficiency

Table 4. Path Analysis Test Results

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-.001	.139		-.006	.996
LNSBH	-.001	.006	-.022	-.202	.840
RISK	.090	.034	.285	2.666	.009
INVEFI	.035	.011	.364	3.348	.001

Source: SPSS Output

Based on the results of the path analysis test shown in table 4, it is known that the efficiency measured by total mudharabah and musyarakah finanacing divided by total mudharabah fund pooling has a significant effect on profitability as measured by ROE with a significance level 0.001. Financing risk has a significant effect on profitability as measured by ROE with a significance level 0.009. While the profit and loss sharing system measured by profit sharing financing has no significant effect on profitability as measured by ROE with a significance level 0.840.

Based on the results of the path analysis test, it is known that the research model in the form of a regression model is as follows.

$Y = -0{,}001 - 0{,}001\ X_1 + 0{,}090\ X_2 + 0{,}035\ X_3$

Y = profitability

X_1 = profit and loss sharing system

X_2 = risk

X_3 = efficiency

Profit and Loss Sharing System and Risk

Based on the results of the path coefficient test, it is found that the profit and loss sharing system variable has no significant negative effect on risk with a p-value 0.226 greater than 0.05 and the coefficient value -0.019. The results of this study cannot prove that the higher the profit and sharing system will affect the risk of financing lower or higher. The findings of this study do not support Muhammad's explanation (2004) that financing is high risk, because banks will always face asymmetric information problems. In a mudharabah contract when the production process begins, the agent shows good ethics for the actions that have been agreed upon together.

However, after running, uncontrolled actions emerged, namely moral hazard and adverse selection. The findings of this study also do not support the research findings (Hadad et al:2004) that the main cause of bank failure is poor bank management, due to over-risk taking, and looser oversight of fraud and embezzlement. Based on the analysis of the research results that have been stated, it can be concluded that the profit and loss sharing system variable does not significantly influence the risk variables in islamic rural banks in East Java Province.

Profit and Loss Sharing and Efficiency

Based on the results of the path coefficient test, it is found that the profit and loss sharing system variable has a significant positive effect on efficiency with a p-value 0,000 smaller than 0.05 and a coefficient 0.184. The results of this study can prove that the higher the profit and loss sharing system will affect the higher efficiency. The findings of this study support the theory described by Hassoune (2002) that the difference between islamic banks is more profitable because of market imperfections, namely the availability of non-remunerated deposits in large numbers which greatly reduces funding costs. This study supports the research conducted by El-Biraika (2001) that the profit and loss sharing system improves finance stability through risk reduction and eliminating conflicts of interest between borrowers and lenders making islamic banking more efficient as an intermediary institution. Based on the analysis of the research results that have been stated, it can be concluded that the profit and loss sharing system variables have a significantly positive effect on efficiency variables in islamic rural banks in East Java Province

Efficiency and Risk

Based on the results of the research path coefficient test, it is found that the efficiency variable has a significant positive effect on risk with a p-value 0.002 smaller than 0.05 and a coefficient 0.089. The results of the study can prove that the higher the efficiency will affect the higher the risk. The findings of this study support the theory described by Arjadiwinto and Riyanti (2013) that in maintaining the level of efficiency, the bank must also be able to apply the principles of prudence and risk management to remain profitable. Many research results prove the existence of an efficiency relationship with bank credit risk. This study supported the research conducted by Syaifuddin (2005) that operational efficiency has a significant effect on the general risk of national private sector in Indonesia. Based on the analysis of the results of the research that has been stated, it can be concluded that the efficiency variable has a significantly positive effect on risk variables in islamic rural banks in East Java Province.

Profit and Loss Sharing System and Profitability

Based on the results of the path coefficient test, the study resulted in the finding that the profit and loss sharing system variable has no significant negative effect on profitability with a p-value 0.840 greater than 0.05 and the coefficient value -0.001. The results of this study cannot prove that the higher the profit and loss sharing system will affect the higher profitability. The findings of this study do not support the theory described by Yazhini (2002) that investment in Islamic financial institutions can provide a potential profit that is balanced with risk to meet the different demand needs of actors in the contemporary environment and with the guidance of Islamic law. The findings of this study do not support the research conducted by Hassoune (2002) that the profitability of Islamic banks is better than conventional banks. This is because the influence of leveling comes from the ability of islamic banks to absorb surprises on asset income through a system of profit sharing and loss. In theory, Islamic banks are in an effective position thanks to a profit sharing system that makes profitability less volatile throughout circulation. While empirical evidence shows that islamic banks are indeed very profitable than conventional banks. Based on the analysis of research results that have been stated, it can be concluded that the profit and loss sharing system variable does not significantly affect the profitability variables in islamic rural banks in East Java Province.

Risk and Profitability

Based on the results of the path coefficient test, the study resulted in the finding that the risk variable had a significant positive effect on profitability with a p-value 0.009 less than 0.05 and a coefficient 0.090. The results of the study can prove that higher risk will affect the higher profitability. Research findings support the theory described by Bashir (2001) that in general, islamic banking operations have characteristics with a high level of risk. These risks include credit risk, regulatory risk and interest rate risk (funding). The risks analysis will affect the performance of Islamic banks. The research findings support the results of research conducted by Mudrajat (2003) using a capital adequacy ratio (CAR) and loan to deposit ratio (LDR) to be used to measure bank specific risks. This variable is used to prove the risk hypothesis affects the profit margin. Based on the analysis of the research results that have been stated, it can be concluded that based on the results of the study, the risk variable has a significantly positive effect on profitability variables in islamic rural banks in East Java Province

Efficiency and Profitability

Based on the research path coefficient test results, the study resulted in the finding that the efficiency variable positive significant effect on profitability with p-value 0.001 less than 0.05 and a coefficient 0.035. The results of the study can prove that the more efficiency will affect the higher profitability. The study's findings support the theory described by Brozen, Smirlock, Evanoff and Fortier (1988) that efficiency is a characteristic that indicates the degree to which the process of generating the required output with minimal costs. The return of Islamic banks has a direct relationship function with the profits generated by the project. The increase and decrease in bank profits depends on the rise and fall of returns from the funded project. When in a profit and loss sharing system, bank profits directly depend on the success of project performance, banks have a great interest in finding

successful projects. Therefore Islamic banks tend to have a high level of efficiency compared to conventional banks. In its support for the efficiency approach, found that certain banking efficiency seems to be the dominant variable in explaining the profitability of the banking industry(Mudrajat (2003). The study's findings support the results of research conducted by Mudrajat (2003) using market share (MS) to prove the efficiency hypothesis affect the profit margin. Based analysis of research results that have been stated, it can be concluded that based on the efficiency variable has a significantly positive effect on profitability variables in islamic rural banks in East Java Province.

Conclusion

Based on the results of the research and discussion, this study concludes that the profit and loss sharing system has no significant effect on risk. This shows that the first hypothesis which states that the profit and loss sharing system has a significant effect on risk is rejected. Theoretically, this finding implies that the profit and loss sharing system is not a fundamental antecedent/predictor that plays an important role in decreasing and increasing financing risk. The profit and loss sharing system has a significant effect on efficiency. This shows that the second hypothesis which states that the profit and loss sharing system has a significant effect on efficiency is accepted. Theoretically, the findings of this study mean that profit and loss sharing financing is a fundamental antecedent/predictor that plays an important role for decreasing and increasing efficiency. Efficiency has a significant effect on risk. This shows that the third hypothesis which states that efficiency has a significant effect on risk is accepted. The results of this study can prove that the higher the efficiency of financing will affect the higher risk of financing. Theoretically, the findings of this study contain the meaning that the efficiency of financing has a significant effect on financing risk.

The profit and loss sharing system has no significant effect on profitability. This shows that the fourth hypothesis which states that the profit and sharing system has a significant effect on profitability is rejected. This is due to the low profit and loss sharing system variability and has not been able to significantly affect the variability of profitability. Theoretically, this finding implies that the profit and loss sharing system is not a fundamental antecedent/predictor that plays an important role in decreasing and increasing profitability. Risk has a significant effect on profitability. This shows that the fifth hypothesis which states that the risk of significant influence on profitability is accepted. Theoretically, the findings of this study mean that financing risk is a fundamental antecedent/predictor that plays an important role in decreasing and increasing profitability. Efficiency has a significant effect on profitability. This shows that the sixth hypothesis states that efficiency has a significant effect on profitability is accepted. Theoretically, the findings of this study mean that the efficiency is a fundamental antecedent/predictor that plays an important role in decreasing and increasing profitability.

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