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MUDHARABAH SAVINGS INFLUENCE ON PROFITABILITY AT SHARIAH BANKS (MAKASSAR, INDONESIA)

This paper aims to measure the extent of Mudharabah savings' influence on profitability at Shariah banks in Makassar (Indonesia). This study employed quantitative research and analyze financial reports of Shariah banks in 2013–2014. The results show that Mudharabah savings positively influence upon the Return on Asset (ROA). The correlation analysis result showed that Mudharabah savings not significantly influence the profitability of Shariah banks.

Keywords: *Mudharabah; Shariah bank; Islamic finance; profitability; return on assets.*

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ВПЛИВ ЗАОЩАДЖЕНЬ МУДАРАБА НА ПРИБУТКОВІСТЬ ШАРІАТСЬКИХ БАНКІВ (ЗА ДАНИМИ М. МАКАССАР, ІНДОНЕЗІЯ)

У статті зроблено спробу виміряти вплив заощаджень мудараба на рівень прибутковості шаріатських банків м. Макассар (Індонезія). З даною метою проаналізовано фінансову звітність шаріатських банків міста за 2013–2014 роки. Результати аналізу показали, що заощадження виду мудараба позитивно впливають на рентабельність загальних активів банку, однак вплив мудараба на прибутковість банків не можна назвати суттєвим.

Ключові слова: *мудараба; шаріатський банк; мусульманські фінанси; прибутковість банку; рентабельність на загальну суму активів.*

Форм. 4. Табл. 5. Літ. 15.

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ВЛИЯНИЕ СБЕРЕЖЕНИЙ МУДАРАБА НА ПРИБЫЛЬНОСТЬ ШАРИАТСКИХ БАНКОВ (ПО ДАННЫМ Г. МАКАССАР, ИНДОНЕЗИЯ)

В статье сделана попытка измерить влияние сбережений мудараба на уровень прибыльности шариатских банков в г. Макассар (Индонезия). С данной целью была проанализирована финансовая отчётность шариатских банков города за 2013–2014 годы. Результаты анализа показали, что сбережения вида мудараба позитивно влияют на рентабельность общих активов банка, однако влияние мудараба на прибыльность банков нельзя назвать значительным.

Ключевые слова: *мудараба; шариатский банк; мусульманские финансы; прибыльность банка; рентабельность на общую сумму активов.*

Introduction. Islamic banking has been always expected to complement conventional banking and other financial institutions. Progress and development of the Shariah in this field is very encouraging, and this sector certainly will be growing in the future. However, development in volumes must be matched with the progress in quality. The quality of Islamic banking is significantly determined by banks' ability to develop their performance and sustainability basing on the Shariah principles, as this strongly influenced by the quality of funds placement.

Business based on the principle of mudharaba has become part of Indonesian Islamic banking since the passing of the law # 7 in 1992, be which banks were given the freedom to determine the type of benefit to be taken from customers, either as

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bank interest or as profit sharing. Thus Islamic banking got increasingly widespread and growing as marked by the approval of Law # 10 as of 1998 (Antonio, 2006). The legislation also provides guidance for conventional banks to open Islamic branches and even convert itself from conventional banking to Islamic banking.

The mudharaba or profit sharing practices are preferred by Muslim customers as this practice is consistent with the Shariah. Indonesia as the largest Muslim country in the world is a huge potential market for Shariah banks in attracting money to be deposited. The principle difference between conventional and Islamic banking concerns the return of benefits or dividends by financial institutions to customers, which is also known as Mudharabah.

Mudharabah is defined as the outcome agreed upon by both parties between fund providers/customers (*shahibul maal*) with fund manager (bank, financial institutions (*mudharib*)). The mechanism consists of that a bank acts as the manager of funds owned by customers/client (the owner of the first funds) collected in various projects to be managed as customer financing (Cattelan, 2010). Secondly, bank acts as both the owner and customer financing fund – as the fund manager second. So the size of profit received by customer depends on the performance of banks and entrepreneurs as well as profit sharing between customers and banks (Hassan, 2010).

To achieve profits as high as possible is the goal for most companies, high level of profits should be linked to value for shareholders as profitability needs to be expressed in the size of the return on assets. Return on assets (ROA) was used to measure the efficiency and effectiveness of company in generating profits by exploiting its assets (Olson and Zoubi, 2008).

The amount of Mudharabah savings will affect the profitability of Islamic banks. Greater Mudharabah savings means there will be greater revenue for mudharabah, so that the net profit will likely increase and of course profitability will increase, and vice versa.

To improve its profitability, the bank will try to improve the collection of funds from available sources accompanied by efforts to improve the quality of productive assets distribution in order to generate more profits.

Table 1. **Mudharabah savings and profitability of Shariah banks in Makassar, 2013–2014** (Shariah Banks Financial Report 2013–2014)

Period (Quarter)	Mudharabah savings, mln IDR	Development, %	Net profit, mln IDR	Development, %
I	4.469.516	-	36.512	-
II	4.341.713	2.86	35.339	3.21
III	4.256.842	1.95	52.492	48.54
IV	4.973.679	16.84	87.435	66.57

According to Table 1, it can be understood that development of Mudharabah savings in Shariah banks over the last two years (2013–2014) fluctuated, in Quarter I – Quarter II it decreased by 2.86%. Next, in Quarter III, the savings increased by around 1.95%. Until the last quarter, savings dramatically increased by 16.84%. This is likely caused by several factors such as the number of customers, the quantity of customers who save in large numbers, the quantity of customers that withdraw their deposits, and the quantity of customers' loans for consumption and production.

Literature review. Islamic banking (Arabic: al-Islamiya or al-Mashrafiyah) is a banking system the implementation of which is based on Islamic law (Shariah). Shariah can be defined as everything that is in accordance with the teachings of Islamic religion, e.g., both fund raising and channeling funds are to provide reward on the basis of Islam. According to A. Samad (2014) *Mudharabah* is limited partnership between parties based on mutual agreement. On the same token, R. Muhamad (2003: 62–63) defines Islamic banks as "financial institutions which provide financing and other services in payment traffic and circulation of money which in its daily operations is adjusted with the Islamic shariah". K. Perwaatmadja (2005: 200) specifies Islamic banking as follows:

a. Banks operating under Islamic principles.

b. Banks whose procedures are referring to the provisions of the Qur'an and the Hadith.

c. Banks operations are following the provisions of the Islamic Shariah.

According to B. Kettel (2011: 189), the conditions to be fulfilled under Shariah and to be called mudharabah, include:

a. Capital should be clearly stated in the exact amount, if it is in the form of capital goods, then goods should be appraised at the equal values/ price in money.

b. Capital must be handed over to mudharib to enable it to do business.

c. Capital must be in hard cash form instead of credit.

d. Profit sharing should be expressed as % of profits produced.

e. The percentage ratio of the agreement must be reached through negotiations and translated into a written contract.

f. New profit-sharing can be done after mudharib (fund manager) return all (or most) of capital to shahib a-mall (client).

In the event of a loss, risk that should be borne by the owner of funds, as long as there is no evidence that mudharib (fund manager) has committed fraud or actions that can be treated as misconduct, for example, corruption, fraud and misappropriation. In this case, mudharib will lose profits (reward for results). Banks and financial institutions in this contract may be one of the parties, both the fund manager (mudharib) in the relations with depositors, or can be the provider of funds (shahibul maal) in dealings with other users of funds.

According to M. Antonio (2001: 9), Mudharabah can be divided into two, namely *mudharabah mutlaqah* and *mudharabah muqayyaddah*:

a. Mudharabah mutlaqah: the owner of funds (shahibul maal) entrusts to fund manager (mudharib) to manage funds in general term or scope, not limited by specifications on the type of business, time or area of business.

b. Mudharabah muqayyaddah: the owner of funds (shahibul maal) specify limitations toward fund manager (mudharib) regarding where, how, and when to invest.

Hypotheses. The proposed hypothesis is that: Mudharabah savings significantly influence the profitability rate at Shariah banks in Makassar, Indonesia.

Research method. This study aims to discover the influence of Mudharabah savings on profitability rate at Shariah banks in Makassar, Indonesia. Population in this study were financial reports of Shariah banks in Makassar (2013–2014). The sample is Mudharabah savings in 4 quarters. In order to answer the research question, this study employes the simple linear regression formula and SPSS software for calculations and analysis.

Table 2. **Differences between conventional bank' interest method and Shariah bank' profit-sharing method** (Kettel, 2011: 207)

Conventional bank' interest method	**Shariah bank' profit-sharing method**
1. Determinations of interest were made at the time of a contract without referring to profit and loss in the future. 2. The percentage is based on the amount of money (capital) lent. 3. Payment is fixed, without considering future potential whether the project is going to profit or lose. 4. The amount of interest payment does not increase even if the amount of profits doubled or the state of the economy is booming.	1. Determination of the amount of profit sharing ratio at the time the contract is made by referring to the possibility of profit and loss. 2. Profit sharing is based on the volume of profits. 3. The results of the project depend on the gain or loss. 4. The amount of profit sharing may increased according to the increase in total revenues. 5. There is no doubting the validity of the method for results.

Data analysis. In order to discover the influence of Mudharabah savings on profitability, this study employed the simple linear regression formula (Lynch, 2013: 27):

1. Simple linear regression:

$$y = a + bX, \qquad (1)$$

where y — profitability; a — constant/estimated values for profitability (Y); b — regression coefficient, the extent of X influence on Y; X — Mudharabah savings.

2. The coefficient of correlation (r) can be determined by the formula as mentioned in Lynch (2013: 30) as follows:

$$r = \frac{n(\Sigma XY) - (\Sigma X)(\Sigma Y)}{\sqrt{n(\Sigma X^2) - (\Sigma X)^2 - n(\Sigma Y^2) - (\Sigma Y)^2}}. \qquad (2)$$

To interpret the r value or the extent of relationship between X and Y, we use the interpretation guide from S. Lynch (2013: 35) as follows: (Table 3).

Table 3. **r-value interpretation**

Interval	Level of relationship coefficient
0.00–0.199	Very low
0.20–0.399	Low
0.40–0.599	Medium
0.60–0.799	Strong
0.80–1.000	Very Strong

3. t-tests are employed on the regression coefficients obtained in the simple linear regression. According to S. Lynch (2013: 44), the formula is as follows:

$$t = \frac{r\sqrt{(n-2)}}{\sqrt{(1-r^2)}}, \qquad (3)$$

where t — t-value; n — the number of observation; r — the coefficient correlation; H_0: $b = 0$, against H_1: $b \neq 0$; H_0 — insignificant coefficient correlation; H_1 — significant coefficient correlation.

To determine the profitability, this study used Return on Assets (ROA) variable analysis, to compare the net income before tax with the average total assets. According to Kuswadi (2006: 94), the formula is:

$$ROA = \frac{Net\ Income}{Average\ Total\ Assests} \times 100\%. \quad (4)$$

Results and discussions.

1. Simple linear regression result. According to the regression test done via SPSS software, it was found that (Table 4).

Table 4. **Mudharabah savings regression test**

Coefficients[a)]

Model	Unstandardized coefficients		Standardized coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.776	.251		3.084	.054
x (Simpanan Mudharabah)	.025	.027	.472	.927	.422

a) Dependent Variable: y (Profitability).

The value of a = 0.776 and b = 0.025, therefore the regression equation is Y = 0.776 + 0.025x. 0.776 of the constant value is the extent of profitability regardless the amount of bank savings. Regression coefficient value obtained is around 0.025, which means that every increase of 1 IDR of *Mudharabah* savings can increase bank's profitability by 0.025 IDR. The result of the equation explained the positive relationship between Mudharabah savings and bank's profitability rate. It also can be translated vice versa.

2. Coefficient correlation analysis (Table 5).

Table 5. **Coefficient correlation,** *authors*

Model Summare[b)]

Model	r	r Square	Adjusted r Square	Std. Error of Estimation	Durbin-Watson test
1	.472[a)]	.223	.037	.490	.634

a) Predictors: (Constant), x (Mudharabah savings).
b) Dependent Variable: y (Profitability).

From the calculation of the correlation coefficient we obtain r = 0.472, this means that the relationship between Mudharabah savings and profitability is 0.472. The correlation coefficient of 0.472 was found in the medium category (based on the interpretation table r value). So there is a relationship between Mudharabah savings and bank profitability. While the coefficient of determination is r^2 = 0.223, or 22.3%, which means that the contribution of Mudharabah savings to profitability of banks amounted to 22.3%, while the rest is determined by other factors amounting to 77.7%.

3. t-test. The t-test is the significance test measuring whether a significant correlation coefficient is obtained or not. In Table 4 the t is 0.927 while t-table of the real level is a = 0.05, degrees of freedom can be calculated with $df = n - 2 = 5 - 2$, so that df = 3, of the results obtained t-table value of 3.182. This shows that t-count is smaller than t-table that is 0.927 < 3.182, so that H_1: $b \neq 0$ is rejected, which means the correlation coefficient is not significant, and this means that the hypothesis that "Mudharabah savings significantly effect on banks profitability ", is rejected.

Basing on the analysis in SPSS, it can be concluded that the Mudharabah savings have a positive (but not quite significant) effect on bank profitability. The resulting positive value means that Mudharabah savings have a positive correlation with banks profitability. If Mudharabah savings increase – the profitability of Shariah banks will increase, and vice versa, if Mudharabah savings decreased, then banks' profitability also decline.

4. Discussion. According to the result of this study, the relationship between Mudharabah savings and bank profitability is placed on the medium level. It means that the preference of customers is still strongly influenced by the conventional banking. The level of competition among banks, whether between conventional banks and Shariah banks, or among Shariah banks is quite competitive. So the product of Mudharabah savings is not quite successfull in attracting funds from the society as higher value added is offered by competitors (Rammal and Zurbruegg, 2007).

Moreover, according to A. Samad (2014), Shariah banks are offering value added, but in this study the results are showing the opposite: the product of mudharabah is perceived as regular product by customers. Moreover, people are still looking for great interest rate from conventional banks, even though the risk of loss is bigger as compared to Shariah banks. The statement "the higher is the risk, the higher the return will be" is quite applicable in this study. Moreover, in line with (Hanif, 2014), customers tend to seek the conventional way in using bank products as the peace of mind is dominant in the decision-making on this matter. At the same time, Shariah banks are not actively educating potential customers by giving them the comparison between conventional and Islamic banks, with all pros and cons (Monger and Rawashdeh, 2008; Muhamad, Melewar and Alwi, 2012; Rafiq, 2014). For religious customers choosing Shariah's product is best analogized as having "a stairway to Heaven". In spite of benefits offered by Shariah products such as mudharabah, it seems that it is still a long way to the top in reaching all of those mentioned pragmatical benefits. Though benefits of Shariah product is ensuring the Islamic way in its operationalization, customers apparently still choose the conventional method in saving their funds, as many of them believe that the procedures of the fprmer are "less attractive and practical in nature" (Rafiq, 2014: 5). Having said the downsides of mudharabah, potentials of it in the future are still promising as stated by J. Graham (2014) according to his study on Canada. Canada is a Western country but is starting to realize the benefits of Islamic finance, especially mudharabah practices, by establishing many Islamic financial institutions and also introduced an MBA course in Islamic finance (Graham, 2014). It can be argue that Shariah banks should innovate in order to compete with conventional banks. Shariah banks not only should be able to educate the society on the long-term benefits of their products, but also should be able to provide value added.

Conclusions and suggestions. From the results of this study, several conclusions can be asserted, they are: ROA on Mudharabah savings have fluctuated results, the value of ROA is likely to increase from the first quarter and decreased on the fourth quarter. However, it can be stated ROA development tends to increase from year to year, meaning that bank management is able to control assets and equity of companies with good performance. Moreover, Mudharabah savings has a positive effect on the level of banks' profitability, that is, when Mudharabah saving increases, bank's profitability will increase as well, and vice versa. Next, the results of the correlation analysis mean that the relationship between Mudharabah savings and profitability is 0.472. While the coefficient of determination was $r^2 = 0.223$ or 22.3%, meaning that the contribution of Mudharabah savings to profitability of banks amounts to 22.3% while the rest is determined by other factors (77.7%). Lastly, basing on the test results it can be concluded that t-count is smaller than t-table that is $0.927 < 3.182$, so that H_1: $b \neq 0$ is rejected, which means the correlation coefficient is not significant, and this means that the hypothesis "Mudharabah savings significantly effect bank profitability", is rejected.

Islamic banks should innovate in their daily operations, they also must be able to educate the potential market in order to attract more funds. Further research can benefit from the following possibilities: to explore the motivation of customers at Shariah banks and to explore the feasible ways of promoting not only the product of mudharabah, but also improving the brand image of the bank overall in order to attract more funds from the society.

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