

CHAPTER II

LITERATURE REVIEW

A. Theoretical Framework

1. Islamic Banking

a. The Meaning of Islamic Banking

Islamic banking is related to all business activities that are related to consonant Islamic Banking and Business Entity Concept. It includes institutional, bussiness activities, and its processes in running the business activities. Islamic banking applies Islamic principles, economic democracy, and the principle of prudence. Islamic banking aims to implement national development to reach fairness, togetherness, and even distribution of social justice. (Law number 21 Year 2008 on Islamic Banking).

Indonesian Islamic banking accounting guideline (PAPSI) in (Husni, 2009) Indonesian Bank defines Islamic banking as: “Islamic Banking is a bank in which apply some principles such as partnership, fairness, transparency and universal and it brings about banking activities based on Islamic principles. Islamic Banking activities apply Islamic economy principles which are characterized as: 1.The prohibition of usury 2. Regardless time and space concept 3. Money as exchange asset, it is not a commodity

4. No speculative activities 5. It is not allowed to use two prices for one goods, and 5. No agreement for two transactions.

2. The Function and Purpose of Islamic Banking

Islamic Banking has 4 (four) functions (Harahap, 2004), they are:

a. Manager Function

Islamic Banking is investment manager of stakeholder assembled by the owner in Islamic Banking in which the business sharing is based on competence, carefulness, and professionalism.

b. Investment Function

Islamic Banking, as investor, shares the funds to productive sectors based on sharia by minimizing the risks.

c. Social Function

Islamic Banking has two social functions, (1) obligatory alms, infaq, shodaqah, and waqf (ZISWAF) and (2) qardhul hasan (Abdurrahim, 2009)

d. Financial Service Function

In this function, Islamic Banking is like a conventional Bank. It is not quite different in its services in terms of clearance service, transfer, collection, payment, letter of guarantee, and letter of credit.

Besides that, there are some purposes to optimize the work of Islamic Banking (Arifin, 2010) :

1) Offering financial services

It focuses on offering banking transaction based on sharia principles and prohibited bank rate-based transaction.

2) Maintaining money value stability

Islamic Banking takes money as exchange tool, not a commodity, and it can use price in exchanging. The system without interest will stabilize money value. So, it becomes a credible exchange tool and transaction unit.

3) Developing economy

Islamic Banking develops economy by giving some facilities which applies certain profit and loss sharing such as *musyarakah, mudharaba, murabahah*, and etc.

4) Allocating source of fund optimally

Islamic Banking convinces that source of fund allocation through investments to some projects will be profitable, in accordance with sharia, and economic profitable.

5) Optimistic approach

Profit sharing principle encourages the bank to choose some projects with long term profits rather than short term ones. Then, the high profit will be distributed to shareholders that can give social profit and economic wealth.

6) Avoiding muslims' dependence toward non-sharia bank

According to *handbook of Islamic Banking*, the main objective of Islamic Banking is to serve financial facilities by operating appropriate financial instruments which are in accordance with stipulations and Islamic Law. Islamic Banking is quite different from conventional bank, it can be seen from its active participation in developing socio-economy of Islamic countries. The main objective of Islamic Banking is not maximizing profit as it happened at other commercial banking systems. It aims to extend socio-economic profit for moslems. (Sjahdeini, 1999)

3. The definition of Sharia Commercial Bank (BUS) and Islamic Business Unit (UUS).

Sharia Commercial Bank is Islamic Bank which gives services in cross-currency payments (Law No.21 Year 2008, article 1 verse 8). Islamic Business Unit, or UUS, is business unit of conventional bank head office that functions as home office of a unit or office and it conducts business activities based on sharia principles, or the work unit of branch office of a bank in foreign countries. It conducts business activities conventionally and functions as head office of an Islamic branch office/or Islamic unit. (Law No 21 Year 2008, Article 1 Verse 10).

4. Sharia Financing

a. The Definition of Sharia Financing

According to Law No. 10/1998, financing based on Sharia term is an agreement between a bank and its customers to return the loan or the debt-claim in a certain period based on profit sharing principle. It Means that should be agreement between goth parties.

Muhammad (2005) Argued that financing in a broader sense is financing expense. It is a financial issued to support a planned investment, individual investment and party investment. While, in narrow sense, financing is some activities done by a financing institution.

Antonio (2001), states that it is not appropriate to use the term loan agreement for financing and credit in Islamic banking. There are two reasons why the term is not appropriate to use. Firstly, loan is a financial relationship in Islam. Secondly, loan agreement is commercial agreement. It means that if someone lends some money, he or she is not allowed to add additional amount of money to the loan as interest because interest is regarded as usury. Moslem scholars agree that usury is prohibited. Therefore, in Islamic Banking, there is no credit term but financing.

b. The Products of Sharia Financing

In Islamic Banking, there are some products of financing.

They are:

c. *Mudharaba*

This kind of financing is a contract related to profit-sharing financing between two parties, the depositor or it is often called *shahibul maal* which provides full investment and an entrepreneur (*mudharib*) to do business activity. It requires profit-sharing as previous agreement between the two parties (Arifin, 2010).

Mudharaba or Trustee Profit Sharing is sharing investment from depositor to a entrepreneur for the purpose of participating in the profits made from the utilization of the fund. There are two parties in this kind of business, depositor that is not doing business or the owner of capital, and entrepreneur that can do the business very well. So, there will be profit to share for both parties. There is a mutual relationship. (Al-Mushlih, 2004)

d. *Musyarakah*

Musyarakah contract is cooperation between two or more parties who have strong purpose to increase the asset value. It also means that there are any kinds of business activities they get involved between two or more people to

integrate all sources both tangible and intangible (Karim, 2004).

This financing is a kind of profit-sharing financing in which depositor as investor gets involved as partnership and also finances the business activities. There is an agreement between customer and bank about the investments will be managed by those parties and there is sharing between them both loss and profit-sharing. *Musyarakah* is life-long business financing, it will finance the operational of the business (Arifin, 2010).

e. *Murabahah*

Murabahah is a purchase and sale transaction and the bank states the profit. Bank as seller, and the customer as buyer. The sale price is the purchase price of the investor and profit additional amount or margin (Karim, 2004:88). Bank and its customers should have a certain agreement about the sale price and term of payment. The sale price is stated in the purchase contract and it can be changed according to the agreement.

f. *As-salam*

As-salam is a purchase and sale transaction on the goods that has not existed yet. Therefore, the good will be suspended and there is a cash payment for the goods. Bank is

as the buyer and the customer is as seller. It seems like a future contract (ijon marketing system), but there is a certain agreement stated previously related to the transaction related to the quantity and quality of the goods, the price, and the acceptance of the goods.

If the goods is accepted by the bank, in banking activities, the bank will sell the goods to the partnership or to the customer bot in cash or in credit. The pricelist of the bank is the purchase price of the customer and profit additional amount. If the bank can sell the goods in cash, it is called financing bailouts. If it is sold in credit, the bank and its customer should make an agreement about sale price and term of payment (Karim, 2004: 89).

f. Istishna

Istishna system is like *Salam*. There is a difference between both systems, the payment in *istishna* can be paid many times by the bank. *Istishna* system in Islamic banking is generally applied on manufacture financing and construction financing (Karim, 2004: 90).

General requirements of *istishna* system is the specification of the goods that has been clearly ordered in terms of type, size, quality, and quantity of the goods. The sale price should be agreed before (pre-agreed). It is stated in

istishna contract and it will not be changed during the period of agreement. If there are some changes after the agreement, the additional costs will be the customers turn to pay. (Karim, 2004: 90)

g. *Ijarah*

Ijarah contract is the sale of usufruct of an asset as an exchange for definite reward. The principles in *ijarah* are almost the same with purchase and sale principles, the difference is on the object of transaction. The object of purchase and sale is goods, and the object of *ijarah* is services. (Karim, 2004: 91)

5. Mudharaba

a. The Meaning of Mudharaba

Mudharaba, or it is often called as an qiradh, means “to decide”. *Mudharaba* comes from the word *dharb*, means hit or walk. The meaning of hit and walk here is the process of people in running the business just like how people walk. Technically, *al- mudharaba* is a form of business contract in which one party contributes the capital. The financier is known as *shahibul maal*, and the other will manage the business. (Antonio, 2001)

Here are some meanings of *mudharaba* according to some experts:

1) *Mudharaba* according to Abdur Rahman L. Doi

Mudharaba in Law term is a business contract between one party and a worker or entrepreneur in which the financier has capital (*property*) or *stock*. The financier is called *rabb al mal*. They have certain agreement related to the business, and it aims to get profit (Sjahdeini, 2007).

2) *Mudharaba* according to Imam Saraksi

Imam Saraksi, a moslem scholar who writes a popular book “al Mabsut” about Law, defines *mudharaba* as: The word *mudharaba* derives from the word “*darb*” (work) on the earth. It is named like that because *mudharib* has a right to work together and get profit-sharing as pre-agreed. The proportionate share in profit is defined by mutual consent. (Wiroso, 2005)

3) *Mudharaba* according to al fiqh experts

Mudharaba is a business contract in which the financier offers the capital to other party and the contract states that they will share the profit as pre-agreed. (Sjahdeni, 1998)

So, it can be concluded that *Mudharaba* is a form of business contract in which one party contributes capital and

the other contributes effort/ work. They are *shahibul maal* as the financier and *mudharib* as the worker or entrepreneur.

b. The Fundamental Law of Mudharaba

In general term, *mudharaba* financing lease reflects suggestion to work hard. It can be seen in hadith and Qur'an: (Antonio M. S., 2001)

ii. Al Qur'an

Surat Al baqarah ayat 198

اللَّهُ فَادْكُرُوا عَرَفَاتٍ مِّنْ أَفْضُنْكُمْ فَإِذَا رَكِبْتُمْ مِنْ فَضْلًا تَبَتَّعُوا أَنْ جُنَاحَ عَلَيْكُمْ لَيْسَ الضَّالِّينَ لَمَنْ قَبْلِهِ مَنْ كُنْتُمْ وَإِنْ هَدَاكُمْ كَمَا وَادْكُرُوا ۗ الْحَرَامَ الْمَشْعَرِ عِنْدَ

“There is no sin on you if you seek the Bounty of your Lord (during pilgrimage by trading). Then when you leave ‘Arafat, remember Allah (by glorifying His praises, i.e prayers and invocations) at the Mash’ar-il-Haram. And remember Him (by invoking Allah for all good) as He has guided you, and verily, you were, before, of those who were astray” (RI, 2004)

iii. Al Hadits

عَنْ صَالِحِ بْنِ صُهَيْبٍ عَنْ أَبِيهِ قَالَ: قَالَ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ ثَلَاثٌ فِيهِنَّ الْبَرَكَاتُ الْبَيْعُ إِلَى أَجَلٍ وَالْمُقَارَضَةُ وَالْخَلَاطُ الْبُرِّ بِالسَّعِيرِ لِلنَّبِيَّتِ لَا لِلْبَيْعِ

From Salih bin suhaib r.a, the prophet SAW said, there are three things that are blessings in them: true purchase and sale, muqaradhah (mudaraba), and mixing wheat flour for

domestic use and it is not for sale (HR Ibn Majah No. In 2280, the Book at tijarah)

6. Principle and Condition of Mudharaba

There are different views about essential principles of *mudharaba*, the view of Hanafiah moslem scholar and jumhur ulama. According to Hanafiah ulama, the essential principles of *mudharaba* are agreement and acceptance. While according to jumhur ulama', it consists of parties who are in agreement, capital, profit, activity of work, and agreement. Those principles are included in ulama Hanafiahs' views besides agreement and acceptance as in the requirements of *mudharaba* contract.

According to the guidance of The Indonesian Council of Ulama, the principles and financing condition of *Mudharaba* are:

- a. Financer (*shahibul maal*) and worker (*mudharib*) are legally capable
- b. The statement of offer and acceptance should be stated by those who are in agreement by considering these things:
 - 1) Offering and Acceptance explicitly indicate the business contract (akad/ agreement)
 - 2) The acceptance is held during the business contract
 - 3) The agreement is on a certificate or in written text, by using correspondence or by using modern tools.

c. Capital is the amount of money or asset contributed by the financier to *mudharib* that aims for doing business activity. The requirements of capital are:

- 1) The capital is in certain amount and type
- 2) The capital can be money or valuable things. If the capital is in the form of asset, it should be measured and it is stated in the agreement.
- 3) The capital is not account receivable and it should be paid to *mudharib* based on agreement, both in cash and in credit.

d. Profit of *mudharaba* is the positive gain remaining after all expenses and capital.

The requirements of profit are:

- 1) It is for those who are in business contract, it is not only for financier but also worker.
- 2) The proportionate in profit is determined by mutual consent and it is stated in pre-agreed ratios based on the agreement.
- 3) Financier is responsible for being loss during the agreement in *mudharaba* and the entrepreneur or worker will not do so. If only, there are undeliberately things happened, indifferent of doing something, or contravene to the agreement.

e. Business activity done by entrepreneur (*mudharib*), as being equilibrate (*muqabil*) of capital contributed by financier, should consider some aspects:

- 1) Business activity becomes exclusive rights of *mudharib*, it is without financier's intervention but he should supervise it.
- 2) Financer will give wide space to be done by the entrepreneur and will not bring about any constrains in order to reach aim of *mudharaba* contract, that is getting profit.
- 3) Financer will not break Islamic Law related to *mudharaba* agreement, and financer should obey the rules during the contract.

While Syafi'i Antonio argued the principles of *mudharaba* :

a. Doers

In *mudharaba* agreement, there should be at least two doers. One party as financer (*shahib al maal*), and worker or entrepreneur as the doer of business activity (*Mudharib* atau '*amil*). There will be no *mudharaba* agreement without those parties.

b. Object

The second factor is logical consequence of business activity done by the businessmen. Investor or financer contributes the asset as object of *mudharaba*, and the workers do business activity as object of *mudharaba*. Capital can be in the form of money or valuable things and workers can contributes their competence and skill just like *selling skill*, *Management skill* and etc. There will be *mudharaba* agreement without these two objects.

c. Agreement

The third factor is agreement, it is a consequence of *an-taraddin minkum* principles (those who are in agreement would fail). People who are in agreement of *mudharaba* should approvingly intend to do so. Financer agrees to contribute capital or asset, and workers or entrepreneurs willingly do business activity.

d. Profit Ratio

The fourth factor is specific characteristic of *mudharaba* agreement, it does not exist in purchase and sale agreement. This profit ratio reflects a financial return that should be accepted by those who are in *mudharaba* contract. *Mudharib* accepts financial return because of his work, and *shohib al mal* gets financial return as his capital or asset. This financial return will keep those who are in agreement from dispute about profit ratio. (Karim A. A., 2011)

7. The Types of Mudharaba

Broadly speaking, *mudharaba* can be divided into two kinds. They are *mudharaba muthlaqah* and *mudharaba muqayyadah* (taqwa, 2017).

a. *Mudharaba Muthlaqah*

Mudharaba muthalaqah is a contract of *mudharaba* between *shahibul al-maal and mudharib*. It does not bind the entrepreneur about place, time, season, commodities, credit or techniques of trade. The discussion of salafus shaleh fiqh ulama frequently use the word: *if al*

masyi`ta (do willingly) from *shahibul al-maal* to *mudharib* and *shahibil al-mal* authorize huge power to do the business.

b. *Mudharaba Muqayyadah*

Mudharaba muqayyadah or it is often called *restricted mudharaba* or *specified mudharaba* is the reverse of *mudharaba muthalaqah*, *mudharib* is stipulated in doing the business in terms of place, time, season, commodities, credit or techniques of trade. The restriction frequently reflects tendency of *shahibul al- mal* when capital provider enters the business.

8. The Benefits of Mudharaba and the Risk of Mudharaba

There are some uses of *mudharaba* :

- a. Bank will get the benefit of profit-sharing if the business profit from customers increased. The loss is the liability of the bank while the profit is shared by the entrepreneur and the bank, even it happens in economic crisis.
- b. Bank will not obligate to constantly pay profit-sharing to the customers. It is in accordance with the revenue of bank so it will not happen *negative spread*.
- c. The return of financing cost is in accordance with the *cash flow*, so it will not aggravate the customers.
- d. Bank is selective and beware (*prudent*) in searching the business, it will consider the halal, secure, and really profitable business and share the profit as it is.

e. Profit-sharing principle of *mudharaba* is quite different from principle of interest. In the principle of interest, bank will demand the fulfillment of financing lease of its customers. The claim consists of interest whenever the customers get business profit even loss in economic crisis.

9. Mudharaba Financing and Human Capital

Saiful Azhar Rosly (2015), Mudharaba places human capital in equal footing. It put forth knowledge, skills, creative ideas, and experience as inputs. Here, human capital will be paid on the basis of the contract of hire (al ijarah amal), but profit sharing. In this way, the mudharib is simply not a person who has no capital in which to start a business. Most importantly, he must have the knowledge and market skills and a proven track record in the business he intends to venture into. The mudharib is financially stable and pursues mudharaba projects as a professional. He is not looking for fat salaries but the lucrative gains from profit-sharing contracts.

The main feature of mudharaba is trust (amanah) which means the rabbulmal stands to lose his capital in the event of losses. Mudharaba is based on partnership of capital and service. In this sense, allocation of profits and losses between the mudharib and rabbulmal must be made with care to prevent gharar(uncertainty) in contractual obligations. In principle, mudharaba provides a system of distribution as follows:

- 1) Profit distribution: the contract specifies a stated fraction or ratio, say 40 percent to rabbulmal and 60 percent to mudharib. The ratio is set on the basis of project risks, value-addition, and liabilities.
- 2) Loss distribution due to market risks: absorbed by rabbul mal.
- 3) Loss distribution due to negligence/moral hazard (ghasib) absorbed by mudarib.

On the loss distribution role arising from market risks, it seems unfair to burden the rabbulmal alone while the mudarib goes free. For example, if \$50,000 is injected in the Mudharaba business and sales only amounted \$20,000, the corresponding loss of \$30,000 shall fall on the rabbulmal. Although the mudarib does not suffer direct financial losses, his real loss will be his opportunity cost he has forgone, that is the income he could have earned if he chose to work elsewhere.

Islamic banking should consider the Mudharaba financing model seriously if it desires to command a market niche. Rules of mudharaba protect the bank from moral hazard since firstly, fixed salary does not constitute Mudharaba expenses. Secondly, as a form of the rabbulmal from claiming the personal wealth of the mudarib (i.e., by due process of the law) if the loss arise from negligence.

10. Mudharaba and Asymmetric Information

At least three factors can help explain why *mudharaba* is difficult to be applied in the banking business. *Mudharaba* financing is also prone to the problem of information cost involving the financial structure of the

banking firm. When information about the manager (*mudarib*) is known to the financier (*rabbulmal*), markets for *mudharaba* capital and *mudharaba* deposits are expected to operate more efficiently.

But how would it be possible for the financier to know that the *mudarib* is a trustworthy partner? How can he be certain that the *mudarib* uses the *mudharaba* capital according to the stipulated covenants? Can Islamic banking control the *mudharaba* operations? Financial intermediation is a natural consequence of asymmetric information, where one party in a transaction has more information than the other. In Islamic banking, the intermediary role is even more problematic, given the variety of new financial products available in the financial market. That is, people with different tastes, preferences and religious affiliation have many options open to them.

Generally, a firm has a number of options to raise capital. In the conventional market, it can use bank loans. On a broader scale, issuing stocks and bonds provides more liquidity, but only companies with high credentials can do so. When the Islamic options provide better prospects, the firms are expected to raise capital via *mudharaba*, *al-bai-bithaman ajil*, and the *mudharaba-musyarakah* principles.

When risk is low, the firm may want to use debt financing. Projects with higher risk profile will likely use equity. Often, when a firm approaches banks for funding, it is likely that the latter has less idea what the former has

in mid. Hence, asymmetric information is a natural consequent of business and human relation.

In *mudharaba* business, adverse selection is finding out of the true risk of the fund user (*mudharib*) before the *mudharaba* funding is injected into the business. The due diligence is the most important thing. The search of due diligence aims to assess risk and value added roles of the *mudharib*.

The bank as *rabbulmal* to requires assess the firm's (i.e., *mudharib*) entrepreneurial visions and objectives. The Bank must investigate the management team and the products and technology involved in the business. Business plans should be able to lay out the firm's market strategy, financial projections, and manufacturing processes.

As the *mudharaba* contract is new term to banking, innovative techniques should be used to appraise project proposals that go beyond traditional risk and credit analysis. The due diligence process is not a banker's cup of tea, but getting new expertise to perform due diligence can steer a *mudharaba* venture successfully and help improve a bank's performance.

One danger is obvious when the bank resorts using the profit-loss sharing ratio as the benchmarking criterion. For example, the bank may offer a prospective *mudharib* a profit-sharing ratio (PSR) of 20:80 (i.e., bank with 80 percent share) instead of a PSR or 60:40. The bank, in the final analysis, may have instead chosen a project run by a *mudharib* who turns

out to be a fraud. The bad *mudharib* does not mind receiving a lower profit share (i.e., 20 percent), since he has plans to deceive the *rabbulmal* after all.

He is willing to accept the less favorable PSR, since he knows how to manipulate the partnership. What happens now is that adverse selection takes place when the bank displaces good *mudharibs* who find the PSR too costly. Of course, in *mudharaba*, the most important variable is the expected profit rate. In some cases, for example contract financing, the expected profit rate is known, and how much profit the bank wants to make depends predominantly on the negotiated PSR.

Adverse selection of good *mudharib* will influence to, the risk of moral hazards that is about monitoring a *mudharib* who unknowingly may have been selected. Hence the bank may have to deal with a *mudharib* who may not be using the *mudharaba* funds in the interest of the project, but for his own selfish interest. Again, the monitoring cost will be substantial, and traditional banks may not be able to bear it. In conventional equity finance, the moral hazards are often seen in the principal-agent problem.

11. Mudharaba Investment Fund

financing in the banking business can be attributed to many factors. One is quite obvious, the Islamic banks are worried that people will place their money elsewhere, since *mudharaba* deposits are risky. That is, a *mudharaba* placement does not provide fixed contractual return. It also does not offer capital protection. As *mudharaba* cannot find ready application,

the role of the interest-free banking system (IFBS) in promoting small and medium-scale industry (SMI), has been marginal. The equity models of banking through *mudharaba* and *musyarakah* has the potential to create dynamic changes in the banking industry. They should be given a chance to prove their worth in the market. It requires a serious commitment from the relevant authorities, namely the Ministry of Finance, Ministry of International Trade and Industry, and the newly formed Ministry of Entrepreneur Development to see successful run of the equity model.

One way is to set up a *Mudharaba* Investment Fund (MIF). Like many development fund offered by the government, such as the New Enterprise Fund (NEF), Bumiputra Industrial Fund (BIF), Principal Guarantee Scheme, etc., the *mudharaba* fund can be managed instead by the interest-free banking system under the guardianship of the Credit Guarantee Corporation (CGC).

In this case, certain policy adjustments are required in the CGC as it would now deal with equity capital rather than loans. The *Mudharaba* Investment Fund (MIF) will help secure the future success of the *mudharaba/musyarakah* approach to banking in this country. My main concern here is about financing small and medium-scale industries. Although many entrepreneurs have attended development workshops to learn the skills of financial management, accounting, and marketing and to acquire numerous motivational tips to sharpen business acumen, the bottom line remains the same, i.e., capital.

Capital is hard to find, especially for start-ups and entrepreneurs who have relatively less exposure to the vendor and umbrella system. They are required to present securities and collaterals that are impossible to find even though the business idea is genuine and has the potential to succeed. It is here equity capital finds its natural path.

The *Mudharaba* Investment Funds can now be used to try out the potentials of *mudharaba/musharakah* instruments in the interest-free banking system. If it is successful, the public can be assured that if it is carefully monitored, the bank can generate more profits from the *mudharaba* system, which also means higher returns for depositors.

The question of fear and worry about investment in the *mudharaba* deposits becomes less stressful. Instead, more people are looking forward to invest in *mudharaba* deposits. The *Mudharaba* Investments Fund can only be set up after careful planning on manpower requirements on projects or risk management undertaken. The IBFS can either set up a subsidiary to execute project monitoring activities or hire consultants to do so. This can be done with the cooperation of the CGC. The *Mudharaba* Investment Fund could be the only way SMIs can obtain capital from equity financing via the banking industry. Presently, equity finance is a privilege for companies listed on the KLSE. For expansion purposes, they can obtain funds from new share issues. So when big business flourishes thanks to equity participation, the small ones remain paralyzed as they are pushed to take loans bearing strict security requirements.

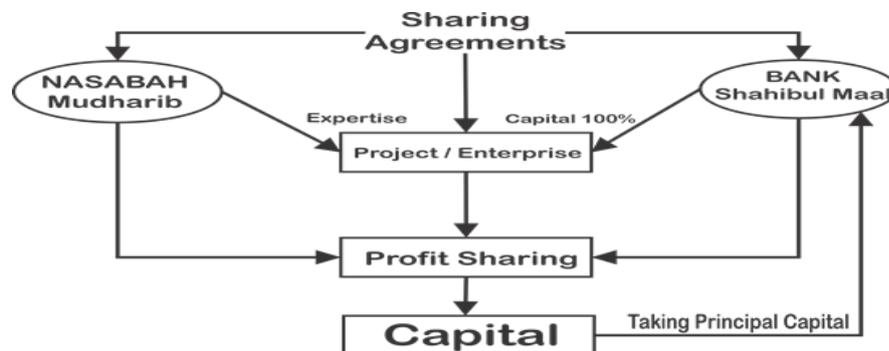
Small firms have to bear this unwarranted burden because the law does not recognize partnership as a separate legal entity and therefore inflicts unlimited liability of losses onto the individual entrepreneur. On the other hand, the corporations, as legal entities, would not be liable for liabilities more than their shareholdings.

12. Human Risk in Mudharaba Business

Based on Saiful Azhar Rosly (2015: 207-209), Can be trust factor amanah become central in a mudharaba business where market risks are high and real losses can be disastrous? One can easily find in mudharaba literature that risks of losses due to negligence are liabilities the mudharib must bear. But losses arising from market risks fall only on the rabbulmal. presiding over mudharaba disputes make the mudharib liable for the losses caused by erroneous business strategies? This will go against the mudharaba principle that says no capital protection except under the purview of negligence. In modern finance, unsystematic risks can be diversified if they are not completely. But systematic or market risk cannot be eliminated. So, any losses made here belong to the rabbulmal.

Sarakhsi in his kitab al-mabsut, “in principle the mudharaba capital belong to the owner, an as soon as the agent takes custodyof the capital, the worker gets wages equivalent to his labor expended in the business transaction. If the agent acts contrary to the instructions of the capital owner, he becomes a usurper (ghasib) and therefore responsible for the capital.”

Picture 2.1 Mudharaba Sharing Agreement



13. Third Party Fund

a. The Meaning of Third Party Fund (TPF)

One of company's constraints in running the business is related to fund. Almost all companies require fund to finance the business, both for routine costs and for expanding the business. The importance of fund for the company makes it tries great efforts to find some sources included to some financial institutions just like bank (Kasmir, 2008:61).

Fund is the most important factor in bank operational. Fund will make the bank keep running, the bank will not function anymore without it. Fund is cash money or assets that are and the bank has control over it. The assets owned by the bank will allow the bank to easily change into cash money. Cash money is not only owned or controlled by the bank or banker, but it also deposited by the other party that can be withdrawn at any time, both at the same time and at many times (Arifin Z. , 2009): 57)

According to (Kasmir, 2008:62), the main sources of bank fund are:

- a. Fund owned by the bank
- b. Fund coming from other institution
- c. Fund from community

Fund from community means fund collected and owned by other party to the bank. The main reason why they contribute the fund is to make their money secure and they can withdraw it at any time they need it (Arifin Z. , 2009:60).

The submission fund from community is relatively easier to get and unlimited fund compared to other sources. It happened because bank will give high interest and also interesting facilitates just like good merchandises and satisfied services. Besides its benefit, there also can suffer a financial loss. It can be found the disadvantages of the fund because it relatively requires high interest cost and promotion cost compared to fund of bank.

So, fund of the other party is fund owned by bank and it comes from the other party or community that wants to save the assets/ money. They have certain purpose doing it, because they want to make sure that their money is safe. As customers, they can withdraw it whenever they need. Fund of the other party is the most important source for bank operational.

b. The Products of the Third Party Funds (TPF) at Islamic Banks

The saving types in Islamic banking are almost the same types as those of conventional banks, but there are some differences in the principles of the products. (Antonio, 2001: 155).

a. Giro Saving

According to Law of Islamic Banking Number 21 year 2008, giro is a saving type that is based on wadi'ah agreement or the other agreement and it is not contended with Islamic principles. The withdrawal of the savings can be done at any time by using cheque payment, giro bilyet, and the other bill of interest, or book-entry settlement. There are two kinds of Giro: 1. Giro that is based on Islamic principles, it has no interest; 2. Giro, that is in accordance with Islamic principles, is based on mudharaba dan wadi'ah principles.

b. Current Saving account

According to Law of Islamic Banking Number 21 Year 2008, saving account is a saving type that is based on wadi'ah agreement or investment fund that is based on Mudharaba agreement or it is based on the other agreement that is not contended with Islamic principles. The saving can be withdrawn based on the requirements and condition in the agreement, but it could not be withdrawn by using cheque payment, giro bilyet, and the other bill of interest, or /and any other things like that. Saving

account consists of two kinds, they are: 1.Saving account that is based on Islamic principles, it has no interest; 2.Saving account, that is in accordance with Islamic principles, is based on mudharaba dan wadi'ah principles.

c. Deposit Saving

According to Law of Islamic Banking Number 21 Year 2008, deposit saving is investment fund that is based on mudharaba contract or agreement or it is not contended with Islamic principles. The withdrawal of the saving is only in certain times according to the agreement between the customers and Islamic banking and/or Sharia Business Unit (UUS). There are two kinds of deposit saving, they are: 1. Deposit saving that is based on Islamic principles, it has no interest; and Deposit saving, that is in accordance with Islamic principles, is based on mudharaba dan wadi'ah principles.

14. Non Performing Financing (NPF)

a. The Meaning of Non Performing Financing (NPF)

In Glossary of Indonesian Bank, Non Performing Financing (NPF) is financing related to non-current account, it consists of a financing that might be of high risk; financing of certain group, doubtful and circulating asset but it can be in arrears in return. According to (Sudarsono, 2007: 123), Non Performing Financing or NPF in Islamic Banking is some credits that are included to circulating

credits, it is related to not good circulating credit, doubtful and get stuck credit, it is related to Indonesian Bank requirement about qualified productive assets

According to (Veithzal, 2007:477), the meaning of NPF or Non Performing Financing is financing that is related to substandard or the work does not meet the target that required by the bank. It can be asset return or conflicted profit-sharing; financing that might be of high risk; financing of certain group, doubtful and circulating asset but it can be in arrears in return.

Principally, the status of NPF is based on timely return of customer' liability to pay with or without interest or timely return the assets. Hopefully, process of timely return and good management will minimize NPF, or in other words high risk of NPF is influenced by the ability of Islamic Banking to running the process of credits. It should need more attention in indicating includes variance of credit and also failure in payment before the credit process, during the instalment credit, monitoring it and controlling the credit.

b. Evaluation to Problematical Financing

The requirement of NPF from Indonesian Bank is 5 %. If it is more than 5%, healthy bank system will be assessed by Indonesian Bank of. It will reduce the value for credit. Credit of financing that might be of high risk; financing of certain group, doubtful and circulating asset but it can be in arrears in return. It is based on

Indonesian Bank about qualified productive assets. There should be a prevention for finding indications in variance of credit and also failure in payment. Here is the pattern:

$$NPF = \frac{\textit{Problematic financing}}{\textit{Total financing}} \times 100\%$$

According to Indonesian Bank, the standard of good NPF is if it is lower than 5%, this variable has 20% of weight and the value of NPF can be indicated as:

If value of NPF:

- o More than 8%, score = 0
- o Between 5% - 8%, score = 80
- o Between 3% - 5%, score = 90
- o Less than 3%, score = 100

If there are increasing of high risks, margin/ interest will also increase. There is no term of interest instrument in Islamic Banking. Islamic financial system only recognizes profit-sharing system and loss-sharing system, and adversely, it does not recognize interest instrument in pre-agreed term.

c. The Calculation of Non Performing Financing (NPF)

Tabel 2.1
The Calculation of NPF based on Customer Payability (Debitor) of Islamic Banking

Financing Types	NPF Category		
	Less Facile	Doubtful	Default
Murabahah, Istishna', Ijarah, Qard	Arrear between 90 days to 180 days	Arrear between 180 days to 270 days	Arrear more than 270 days
Salam	The due is up to 60 days	The due is up to 90 days	The due is more 90 days
Mudharaba, Musyarakah	Arrear up to 90 days. The realization of profit-sharing is between 30% up to 90% of income	Arrear between 90 up to 180 days. The realization is 30%	Arrear more than 180 days; the realization is less than 30% of more than 3 period of income

15. Profit-sharing Percentage for the Bank

According to (W.Kolari, 1995), total financing demand/ loan over the community is in reversed to the interest rate. It means that the more interest rate the less the borrowers, and vice versa.

Islamic Banking applies profit-sharing system to financial product of NUC (Natural uncertainty contract), it is a business contract that unstated about time and total of predicted income, just like stated-values share in mudharaba and musyarakah agreement.

The determination of profit-sharing ratio is defined by considering reference of profit margin ratio and prediction of interest rate of financing lease the project/ business. There is negative correlation between profit-

sharing ratio and loan (financing) in which the more profit-sharing ratio accepted by bank the less financing rate or loan rate.

16. Economic Growth Theory

There are some Economic Growth Theory in related literature, they are:

a. Scumpeter Theory

The theory firstly appeared in German language in 1911. It was translated into English in 1934 entitled *The Theory of Economic Development*. Scumpeter explained about development process and the main factors to determine development of economy entitled *Bussines Cycle* and it was published in 1939. The main factors for developing economy is innovation process, the doers of economy development is investors or entrepreneur. Advancement of economy can be applied by using innovation by entrepreneurs, and it means that there is increase in total output of people.

A good environment will enable people to be more creative and it will create pioneer of entrepreneurs. They get new ideas to grow economy. There are two factors that affect entrepreneurs to be more innovative, they are: getting new ideas and credit system that provides funds for entrepreneurs to make their dreams come true.

Credit system here is to provide funds for people who do not have their own assets and they tend to use the assets to create some innovations. Without credit system, people owning funds will only be the innovators.

b. Harrod-Domar Theory

The theory was firstly stated by two economists after Keynes, Evsey Domar and Sir Roy F. Harrod. Domar firstly proposed in 1947 in a journal entitled *American Economic Review*, and Harrod proposed the theory in 1939 appeared in *Economic Journal*. The theory firstly developed by the two economists, and it is known as Harrod-Domar theory.

B. Previous Research

A research held by Marchela Endah Loevyati (2011), it is stated that there are some factors underlying Mudharaba contract. The research examined the influence of fund variable of third party (TPF), profit sharing and inflation rate on mudharaba financing in Islamic Bank in Indonesia. The data were taken from Sharia Commercial Banks in Indonesia, from some financial reports from January 2006 to December 2009. The method applied in the research was multiple linear regression analysis. Based on the research, there are some factors that influence mudharaba financing in Sharia Commercial Banks, they are third-party fund (TPF), and profit sharing ratio. It can be found that inflation variable was not significant.

According to research held by Nugroho Heri Pramono (2013), it is about the financing optimalization on profit sharing-based in Islamic Banks in Indonesia. The research aims to know whether there are simultaneously and partially influence of mudharaba deposit, profit sharing, and profit sharing ratio on financing toward Islamic Banking. Population of the research was 11 Islamic Banks in Indonesia, the sample of the research was taken 5 of

Islamic banks. The criteria of choosing the sample was using *purposive sampling*. Analisis Unit used in the research was quarterly financial report of Islamic Banking since 2010 to 2012. Method of data analysis used in the research was multiple linear regression analysis. It can be found that there is simultaneously positive influence of mudharaba deposit variable, profit sharing, and profit sharing ratio on financing profit sharing-based. Partially, there is significantly positive influence of Mudharaba deposit variable and profit sharing on financing profit sharing based. But, there is not profit sharing ratio is not significantly influence on financing profit sharing-based.

According to research held by Agustina Kurniawanti dan Zulfikar (2014), it is about Analysis on Some Factors that Influence Financing Volume Profit Sharing Based in Islamic Banks in Indonesia. The research analyzed some factors that influence profit and loss sharing volume financing based in Islamic Banks in Indonesia since 2009-2013. Method of data analysis was SPSS, the result of the research shows that there is significantly positive influence of profit and loss sharing ratio and total assets on profit and loss sharing volume financing based, while depositor fund and non performing financing were not significantly influence on profit and loss sharing volume financing based.

According to research held by Wuri Arianti N.P dan Harjum Muharam, S.E., M.E in her research about Analysis on the Influence of Third Party Fund (DPK), Capital Adequacy (CAR), Non Performing Finance (NPF), and Return on Asset (ROA) on Financing in Islamic Banks. The research

determined the correlation between Third Party Fund (DPK), Capital Adequacy Ratio (CAR), Non Performing Keuangan (NPF) and Return On Asset (ROA) with total Islamic Banking financing. The sample of the research was quarterly financial report of Bank Muamalat Indonesia period 2001-2011 by using purposive sampling method. The data used was secondary data of financial report published and downloaded by official website of Bank Muamalat Indonesia. Method of data analysis was some regression with ratio significant 5%. The result of the research shows that only DPK is significantly positive influence financing, while CAR, NPF, and ROA did not influence on financing. DPK, CAR, NPF, and ROA were significantly influence on financing. It can be proved by the value of significance sig-F 0.000 was less than 5%. It can be predicted that the influence of the four variables on financing 98.9%, it was like adjusted R². While the rest was 1.1%, it was influenced by another factor that is not stated in the method of the research.

According to research held by Isnaini Fajrin Nadia Palupi (2015), in her research about Analysis of Third Party Fund, profit sharing ratio, Non Performing Financing and Private Asset on Financing Profit Sharing based Volume in Islamic Banking in Indonesia. The research was held to know Private Asset on Financing Profit Sharing based Volume in Islamic Banking in Indonesia, a Study Case in Bank Muamalat Indonesia. The research was to know the influence of Third Party Fund, profit sharing ratio, Non Performing Financing and Private Asset on Financing Profit Sharing based Volume in

Islamic Banking in Indonesia. Sample of the research was a company since 2003-2013. The data source was quarterly financial report on balance, income statement, financial ratio report of Bank Muamalat. Method of the research was multiple linear regression analysis.

The researcher used classical assumption experiment that included normality, multicollinearity test, heteroskedestisitas test, and correlation. The experiment used model F, R², and t. It can be found that result of the research shows $F_o = 331.425$, it was more than $F_{tabel} = 2.84$, and the level of significance was less than 0.05. The R² shows that adjusted-R² was 0.968. While t showed that (1) The third party fund is significantly influence on profit sharing financing volume (2) Profit sharing ratio is not significantly influence on profit sharing financing volume (3) non performing financing is not significantly influence on profit sharing financing volume (4) Private asset is significantly influence on profit sharing financing volume.

According to research held by Fauziyah Adzimatinur, Sri Hartoyo and Ranti Wiliasih (2016) about Some Factors that influence Quantity of Financing in Islamic Banking in Indonesia. The research used *Vector Error Correction Model (VECM)* method to know long term influence and response on shock that happened in the variables. The research shows that there is significantly positive influence of long term profit sharing ratio, TPF, and FDR on financing, while NPF is negatively significant on financing. ROA and BOPO are not significantly influence on financing. The shock of NPF and ROA on financing is positively responded by financing and it will be

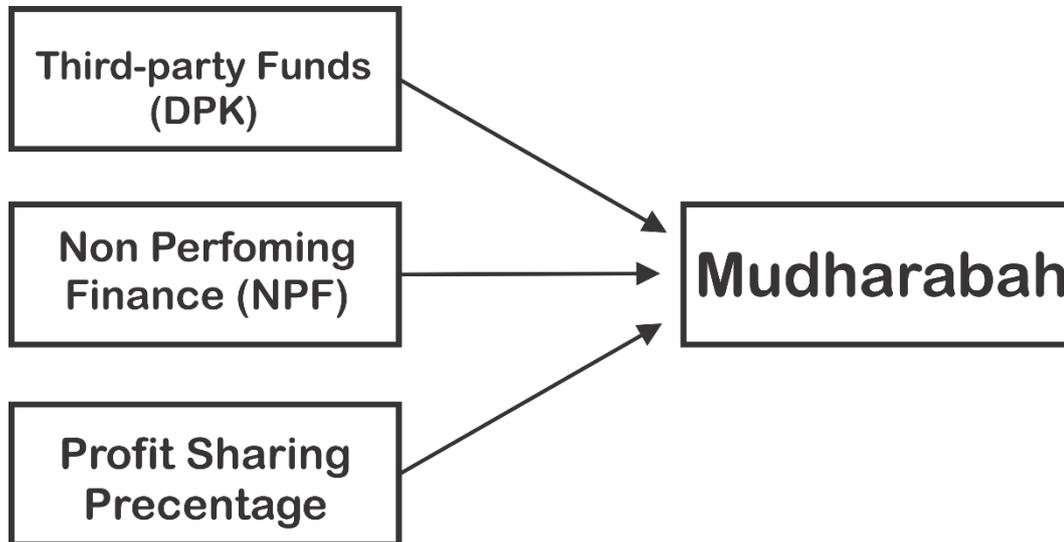
stable in long term period. While the shock of profit sharing ratio, TPF, FDR, and BOPO are negatively responded by financing and it will be stable in long term period.

The difference between the research and previous researches are they used VECM method, time of the research and some variables used in the research. VECM method used in the research was to know whether variable of the research can give shocking effect to dependent variable, the dependent variable of the research was Mudharaba financing. Time of the research was held between 2006-2009 and 2011-2015. The independent variables were TPF, NPF, and profit sharing ratio.

C. Research Framework

Based on the theory and previous research, it can be concluded that the effect of independent variable just like musyarakah dan mudharaba financing on independent variables (Third Party Fund, *Non Performing Financing*, and Profit Sharing Percentage) to dependent variable (Mudharaba). As elaborated above, variables that can influence Mudharaba based on recent condition on Sharia Commercial Bank and Sharia Business Unit in Indonesia from (2006-2009) until (2011-2015). The variables can be drawn as:

Picture 2.2 Framework



D. Hypotesis

Based on review on related research and theories, the hypothesis are as follow:

Ho :

1. It can be assumed that Third Party Fund variable is not significantly influence on Mudharaba financing.
2. It can be assumed that Non Performing Finance (NPF) is not significantly influence on Mudharaba financing.
3. It can be assumed that Profit Sharing Percentage is not significantly influence on Mudharaba financing.

Ha :

1. It can be assumed that Third Party Fund variable is significantly positive influence on Mudharaba financing.
2. It can be assumed that Non Performing Finance (NPF) is significantly negatif influence on Mudharaba financing.
3. It can be assumed that Profit Sharing Percentage is significantly positive influence on Mudharaba financing.

