CHAPTER II

LITERATURE REVIEW

A. Theoretical Review

1. Definition of *Sharia* Banking

In the Indonesia Constitution of number 10 year 1998 section 1 article 3 & 13 states that *sharia* banking is public banks that implement business activities under the *sharia* principle. This principle is based on the rules of agreement which surrounds to Islamic laws (*Quran* and the *Sunnah*) between the bank and another party to deposit funds and or financing business activities, or other activities that are in line with *sharia*. These other activities could be financing in terms of production sharing, modal inclusion, transaction of selling and buying, renting, sending money, and other bank services.

Sharia banking is everything that has to do with *sharia* bank and business unit of *sharia*, which includes institutional, business activities with methods and process in implementing its business (Constitution of Indonesia number 21 Year 2008 on principle of *sharia* banking). *Sharia* banking refers to a system of banking or banking activity that is consistent with the principles of the *sharia* (Islamic rulings) and its practical application through the development of Islamic economics.

Sharia banking has the same purpose as conventional banking except that it operates in accordance with the rules of *sharia*, it is known as *Fiqh al-Muamalat* (Islamic rules on transactions). The rules and practices of *fiqh muamalat* look from the *Quran* and the *Sunnah*, and other secondary sources of Islamic law such as opinions agreement among *sharia* scholars *(ijma')*, analogy *(qiyas)* and Islamic reasoning *(ijtihad)*.

In operating its activities, *sharia* bank uses basic principles. These principles are as follows :

a. Justice Principle

   This principle reflects from the incentive applications of production sharing and returning the profit margin that has already been agreed within the bank and the client.

b. Welfare Principle

   Sharia bank is a place of client saver funds, client modal users, and banks where their position is equal between client saver funds, client modal users, and bank.

c. Serenity Principle

   A product of *sharia* bank that is already adjusted to the *sharia* principle and *Muamalah* rule which does not consist of usury elements and application of tithe asset. With that, clients will feel mentally and emotionally serene.

2. Operational Activity of *Sharia* Banking

In the Indonesian Constitution Number 1 Year 1998 about "Agreement Letter of the Board Directors of Bank Indonesian No. 32/34/KEP/DIR on 12th of May 1999 that talks about Public Banks that are in line with *sharia* and of No. 32/36/KEP/DIR on 12th of May 1999 on *Sharia* Bank", all process transaction in the *sharia* bank must be adjusted to all of the rules that still apply.

Good activities of the *sharia* bank on funding and investing or giving services based on Executing Guidance Office of *Sharia* Bank, Indonesia Bank (1999) are the following :

a. Funding

The activity of funding can be taken by banks from mechanisms of savings, transfers, and deposits. Savings, transfers, and deposits for *sharia* banking are distinguished from other banking. These mechanisms could be differentiated by two types which are savings and transfers that are based on settlement of *wadiah*. Then, there are savings and transfers that are based on *mudaraba* settlement. On the other hand, particularly for deposits, it uses *mudaraba*, because deposits are used for the importance of investment.

b. Lending

In the society, lending could be taken by banks in a form of *murabaha, mudaraba, musharaka,* or *qardh*. Banks as a provider of funds will have compensation in a form of profit margin for *murabaha*, dividend results from *mudaraba* and *musharaka*, and administration financing for *qardh*.

c. Bank Service

Services of Bank Businesses are in the form of giving bank guaranty such as *Kafalah*, Letter of Credit (L/C), *Hiwalah*, *Wakalah*, sales and purchase of foreign currency.

3. Financing Functions of *Sharia* Banking

M. Syafi'i Antonio (2001) stated that financing is one of the most important functions of a bank. The financing itself can be defined as giving financial facility to fulfill the needs of certain authorities that are also unit of deficit. However, the Constitution of Indonesia No 10 Year 1998 about banking states that financing that is based on *sharia* principle is providing money or claims which both terms are based on an agreement or settlement between the bank and clients that require people that has been funded to pay it back after a certain amount of period with profit sharing or incentive.

The difference between the credits from a conventional bank with financing from a bank that is based on *sharia* principle which is from the expected profit. Conventional banks get their profits from interest rates. On the other hand, *sharia* bank only gets its profit from rewards or profit sharing.

The function of financing based on *sharia* has many other functions, other than to increase the money power, the circulation and transit of money, enthusiasm of work, as a tool to stabilize economy, to search for profit and to find ways to attract customers in the banking of Indonesia, but also to create a save environment for business, some functions that are in line with this are :

1. To give finance with *sharia* principle that uses the system of dividing rewards without burdening debtors.
2. To help the weak those are not connected to conventional banks because they cannot fulfill the standards that are used in those banks.
3. To help the lower class society who in the hands of creditors by helping the business finance of those people.

4. *Mudaraba* Financing

Mudaraba is one of the business cooperation between two actors, where the first actor (*shahibul maal*) that provides all of the modal, while the second actor processes the business. For the actor who provides all the funds is also called the investor or *shahibul maal*. However, the actor who processes the business is also called *mudharib*.

Mudaraba principle has one way that could be used in *syirkah* or partnership, where the bank side is the financier and the client is the *mudharib*. When the business that managed by *mudharib* get profit from their market, the business then will also divide its results in *mudaraba* way. This process will always go through a starting agreement. If the business experience loss or deficit, then it will be handled by the financier through the disadvantage. This will only happen when the loss or deficit is not caused by negligence of managing modal. However, if the deficit or loss is caused by fraud or bad managing of modal, then the person who manages the business in the first place will have to be responsible for his or her own loss.

The role of *mudaraba* in the empowerment of a developing *sharia* economy is very crucial. *Mudaraba* could create a fair, equality, and pressure on getting good achievements and that entire risky job is a part of the process. Because of the high risks in *mudaraba*, *sharia* banking rarely does it. The priority of *sharia* banking is actually *murabaha* product (the process of buying and selling).

Murabaha product, the process of buying and selling, is popular among *sharia* banking because of its clear profit prospect, but the risk of it all is very small. Indonesia Bank as the regulator has assisted to *sharia* banking on decreasing the financing of *murabaha* process (selling and buying) and increasing the principle of profit sharing or *mudaraba*. However, the demand of customers or clients lean more on constant financing which is in the process of *murabaha*. (Hilmi 2006; 8).

The practice of *mudaraba* contract is almost the same for small risk business. Because of that, application of *mudaraba* transaction in *sharia* banking is believed to have disguised interest.

The ratio calculation of dividing result is very dependent on the risk that might happen. The higher the percentage of risk, the greater the ratio of dividing result process and vice versa. This causes the manager of *sharia* banking to be very selective in choosing the business that will be handled by *sharia* banks.

In general, *mudaraba* can be divided into two : *mudaraba mutlaqah* (Unrestricted Investment Account) and *mudaraba muqoyyadhah* (Restricted Investment Account).

a. *Mudaraba Mutlaqah* (unrestricted)

   Mudaraba Mutlaqah or could be called Unrestricted Investment Account is a work plan for two clients or more, or between *shahibul maal*, as the investor, and the *mudharib*, as the valid entrepreneur. In other words, the manager (*mudharib*) will get discretionary right in managing finance, type of business, location of business, time of business, or other rights.

b. *Mudaraba Muqoyyadah* (restricted)

   This could also be called restricted investment account, which is the partnership between two or more people or between *shahibul* *maal*, as the investor, with the entrepreneur or *mudharib*. In this process, the investor gives a restriction towards choosing the type of business that they will finance, such as type of utilities, risks, or even other restrictions.

5. The Advantages of *Mudaraba* Financing Product

Mudaraba products are financing products where the bank services as the owner of the finances with the client (as the *mudharib*) who has the knowledge and skills to create a productive and *halal* business. The profit sharing from the usage of the finance will be divided according to agreement ratio. *Mudaraba* settlement is used by bank to facilitate the fulfillment of the business of the clients by giving modal to their business or project.

The advantages of *mudaraba* financing product are the *mudaraba* transaction that is trusted to be more *sharia* compared to other financing products. In this type of financing, *mudaraba* is a source of income and wealth that is guaranteed its business activity. This could be seen by the portion of "profit sharing" given by the bank with the client. The result will be according to the business productivity that will be process by the client, not influenced by the sum of loan that the client will take. This process is advancement in an easier process and the profit to both the bank and the client.

In creating a settlement of *mudaraba* financing must fulfill characteristic of harmony and conditions of *mudaraba*. There are five principles towards *mudaraba*. They are modal holder (*Shahibul Maal*), executor/ businessmen (*Mudharib*), Modal (*Maal*), Project/ Business, Profit, and *Ijab Qabul*. There are also requirement condition of *mudaraba* which are modal and agreement. For the modal holder and the business client must talk in terms of law and representative. The requirement in terms of getting modal which is in the form of money and money nominal is clear. Another condition must be in form of cash and not in loan form, and must be given to *mudharib*. Because of that, if the modal is in a form of item, in the opinion of *ulama fiqh*, in that condition it is not allowed. This is because it is hard to put in a profit term. In the term of profit, the settlement of it is that the profit must have a clear quantity and the profit must be a general part (*masyhur*).

6. The Risks on *Mudaraba* Transaction

Other than the advancement already given before, *mudaraba* transaction also has risks that might happen and we must anticipate. They are :

a. Side steaming is the customer using funds that are not in line with the contract from the start.

b. Intentional negligence and errors.

c. Hiding profits by untrustworthy customers or clients.

7. DPK (Third Party Funds)

In the thoughts Kasmir in his book *Manajemen Perbankan* (2002:64), third party funds are funds that look from the society that is also one of the most important sources in the operational activity of banks. It is also a measurement of successful banks that are able to pay the operation by this financial source.

Constitution of Republic of Indonesia on Banking No. 10 year 1998, the source of finance that is being explained is the following :

a. Giro is a deposit which its withdrawal can be done at any time by using check, gyro billet, or other govern types of financing.

b. Deposit is savings which its withdrawal can only be done from certain times according to the agreement between the client and the bank.

c. Savings are reserves which its withdrawal could only be done according to certain agreed requirement. However, it cannot be withdrawn by check, gyro billet, and or other same type of utilities.

On the other hand, third party funds could be defined as a total of third party funds that is maintain by *sharia* banking, such as sum of gyro *wadiah*, *mudaraba* savings, and *mudaraba* deposits. *Sharia* banks could give gyro savings services in a form of *wadiah* account.

By doing this, *sharia* banks could use the *wadiah yad dhamanah* principle. The bank as a custodian, must guarantee the return of payment the same nominal value of *wadiah.*

8. Profit Sharing

The difference between Islamic economic system and other economic system is in the terms of interests. In Islamic economy, the interest is standardized as usury that is unclean or *haram* in the *shariat*. This causes economy with *sharia* condition to not have a standardized interest, but it is replaced by the profit sharing system that is valid in the *sharia* condition and it is allowable (*halal*).

The profit sharing principle is a general characteristic and basic premise of the *sharia* bank operation. From this principle, *sharia* bank could function as cooperation, in terms of depositor or business that uses the loan from the bank.

The profit sharing is a practice of the *sharia* banking that implement in the system. It is also a partnership between investors and entrepreneur to create an economical business. Between those two actors (investors and entrepreneur), there will be a contract in the business that they will create. In the settlement there will be a profit sharing process that must be agreed in the start of the contract.

The profit sharing process is one the most important process of credit distributor or financing. With a high profit sharing process there will be a high profit sharing process from the financing distributor.

9. SWBI Bonus (*Wadiah* Certificate of Bank Indonesia)

SWBI Bonus (*Wadiah* Certificate of Bank Indonesia) is one of the monetary instruments of Indonesia Bank for the *sharia* banks all over Indonesia. It has a function to absorb the advancement of *sharia* banking in terms of liquidate. Indonesia Bank does vary of market operations to control the money that is available.

To create an implementation of open market based on *sharia* principle, the key is to specialized tools. The tool that is suitable for the *sharia* principle is SWBI or *Wadiah* Certificate of Bank Indonesia (Asy'ari, 2004). The settlement that is used to create this certificate is *wadiah* settlement where it is controlled in Fatwa DSN No. 01/DSN-MUI/IV/2000 about credit transfer and Fatwa DSN No. 02/DSN-MUI/IV/2000 about savings.

Wadiah Certificate of Bank Indonesia (SWBI) is also useful to control monetary jurisdiction. The participation that is done by *sharia* banking in the jurisdiction monetary system could create bonus by Indonesia Bank for the loaning finance that is already calculated at the due date. From the *wadiah* principle, the quantity of the bonus is not agreed at the start of the agreement between *sharia* banks that has deposited with the Indonesia Bank as the depositor. The bonus cannot be standardized in a form of nominal or percentage, but it is a voluntarily form.

10. NPF (Non Performing Financing)

Maula (2009) said that NPF or Non Performing Financing is a comparison of the sum of stalled financing with all of the financing that is distributed by *sharia* banking. The comparison is also in a form of percentage. NPF is a condition where a client is unable to pay a part of all of the liability of the bank as the first settlement created.

NPF happened because of barrier or even lack of ability of the client to pay the gradually installment or financing of dividing result process that is affected by the level decrease of the dividing result process that will be divided to the finance holder. If the level of dividing result process decreases, the influence of it is the loss of investor's finance (withdrawal risk) that will then create liquidity risk towards *sharia* bank (Ambarwati, 2008).

The factors that influence the finance problem is the internal factor banking such as weak analysis of credit, weakness of credit documents, weakness in controlling the credit, indecency of the bank workers, and weakness in warrant. However, besides internal factors, there are always external factors such as ; client is weak character, client weak skills, and calamity experienced by the client, client indecency, and client weak managing skills.

In Andreany (2011), Dendawijaya stated that the influence that credit problems will give to the bank is losing chances of getting profit from the given credit. This will also lead to problems in having profit and will always influence the banks ratio earnings.

11. ROA (Return on Assets)

Return on Asset is a ratio between clean profits and an inverse proportional of all assets to create profits. The ratio points out how big of the clean profit that is found by the measurement of assets by the industry. ROA analysis or could be translated as rentability economy measure the past profit industrial development. The analysis is then presented to the present and future times to see if the industry is able to create more profits in the near future.

In judging a healthy bank. Indonesia Bank will get a maximal score of 100 and if the bank has ROA value of 1,5 %. If the value of ROA of one bank is greater, then the profit reached by the bank will also be greater and also greater the position of the bank from the degree of assets.

12. CAR (Capital Adequacy Ratio)

Capital Adequacy Ratio is a capital ratio that shows the ability of the bank in serving funds towards the need of business development and accommodating the financial loss risks that is caused by the operational bank (Ali in Pratama, 2010).

The high sufficient capital could be influence the ability of the bank, in efficiently processing financial distributor or financial towards the society. If the capital fund that is owned by the bank is able to accommodate the financial loss that will always happen, then the banks could also process its business activities in an efficient way. This also means the greater banks wealth and vice versa.

B. Hypothesis Slope and Previous Research Results

1. DPK (Third Party Funds) and *Mudaraba* Financing

The prioritized activated in *sharia* bank to collect funds from the society in a form of gyro, savings, and deposits to accommodate it back to the society in a form of credit or payment. Because it is the most important source of financing in the *sharia* bank, then a bank must have the ability to assemble funds from a third party.

In the research of Andraeny (2011), stated that DPK positively and significantly influence *mudaraba* financing. This means the greater funds that are assembled, then the greater the financial accumulation of the *sharia* bank in the process of *mudaraba* financing and vice versa, the lower the funds that is collected, then the lower the *mudaraba* financing.

DPK has a strong influence towards financing. This is because DPK collected from the society is the biggest funds that will be controlled by the bank, in this case in *mudaraba* financing. This means that the bigger the level of savings in the *sharia* bank, then the greater the *mudaraba* financing that will be done by the bank.

From the explanations above, a research is done. The first hypothesis that is proposed is the following :

H_1 : DPK influential positively to *mudaraba* financing.

2. Profit Sharing and *Mudaraba* Financing

Profit sharing is a form of return from the investment contract, however from time to time, it will not be constant. The amount of its returning will be based on the result of the business that is truly collected. (Fauziyah, 2006).

Muljono in Andraeny (2011) stated that the amount of profit wanted or (profit-target) is one of the standards on creating the credit value that is distributed. So that, the level of profit sharing of payment is one of the most important factors in finding the amount of *mudaraba* financing that will be distributed.

Ambarwati (2008) in has research stated that the level of profit sharing also positively influence towards *mudaraba* financing to *sharia* public bank. This is also in line with research done by Syam (2012).

Profit sharing that is accepted by the bank will be determined on how much the level of profit towards the scolling of *mudaraba* financing. Therefore, the accepted profit sharing by the bank is very much influenced by the amount of *mudaraba* financing. This means that the higher the level of profit sharing, then the higher the *mudaraba* financing.

From the explanation above and the research already was done, then the second hypothesis is proposed which is following :

H_2 : Profit Sharing influential positively to *mudaraba* financing.

3. SWBI Bonus and *Mudaraba* Financing

SWBI (*Wadiah* Certificate of Bank Indonesia) are certificates that are published by Indonesia Bank as an liquidity instrument of *sharia* bank that its functions to accumulate surplus of funds from the *sharia* bank. The role of SWBI for *sharia* bank is to protect the liquidity when there are no funds in the money market or from Indonesia Bank.

In a certain condition caused by risk factor, SWBI is more meaningful to *sharia* bank compared by financing accumulation. If the level of SWBI bonus is greater, then the amount of financing that will be accommodated by *sharia* banking will be even less, and vice versa.

Haryadi (2009) in his research concluded that SWBI bonus (*Wadiah* Certificate of Bank Indonesia) negatively and significantly influence towards the *mudaraba* financing. The greater the money that the *sharia* banks collected in a form of SWBI, the lower of financing that is accumulated by the *sharia* banking. On the other hand, if the SWBI bonus is collected lessens, and then the greater the amount of funds accumulated in a form of financing towards the society.

From the explanations above and research that has already done, then a hypothesis is proposed as the following :

H_3 : SWBI bonus influential negatively to *mudaraba* financing.

4. NPF (Non Performing Financing) and *Mudaraba* Financing

NPF is a condition where a client is unable to pay a part or all of the required needs to the bank of the first agreement. The greater of NPF will influence towards increasing the amount of (PPAP) allowance rasure productive assets that must be formed by the requirements of Indonesia Bank. If this is continuously happening, then it will decrease the *sharia* banks capital that will influence towards the banks ability in gathering payment which is also a part of *mudaraba* financing.

Lukman Dendawijaya (2005) believed that the implication for the bank as the effect of problematic credit will cause loss of chances in getting income from the given credit. This also effects towards the profit intake which will badly influence the profitability of the bank.

Andraeny (2011) in his research also stated that non performing financing negatively influence insignificantly towards the volume of *mudaraba* financing in the *sharia* bank of Indonesia.

From the explanation above and the research that was implemented, then the fourth hypothesis is proposed as the following :

H_4 : NPF influential negatively to *mudaraba* financing.

5. ROA (Return on Assets) and *Mudaraba* Financing

Analysis on Return on Asset functions as a profitability of economy to measure the development of industries in creating profit in the past. This analysis is then implemented towards the future period to see if the industry is able to create an even greater profit in the near future. If ROA of a bank increases, then the greater the levels of profit that will be gotten by the bank and the greater the position of the bank from the asset control.

When the bank got a greater level of profits (ROA), then the greater the managing efforts of the banks towards investing the profits into activities that will create profitable management especially in financing distributing.

Triasdini (2010) said that ROA impact on credit distribution working capital. It is not in line with research done by Arianti (2011) stated that ROA not affect the financing of *sharia* banking

From the explanation above and a research that was conducted, then the fifth hypothesis is proposed in the following :

H_5 : ROA influential positively to *mudaraba* financing.

6. CAR (Capital Adequacy Ratio) and *Mudaraba* Financing

The value of CAR could increase the level of confidence of bank in financing towards the society. Ni Luh (2011) in his research stated that CAR positively influence significantly towards credit distribution. This is also in line with the research done by Himaniar (2008) that also stated that capital adequacy ratio positively influence significantly towards distributing funds of *sharia* bank.

From the explanations above and the research conducted, then the sixth hypothesis is proposed as the following :

H_6 : CAR influential positively to *mudaraba* financing.

C. Type of Research

The type of research shows the connection between independent variables which are DPK (Third Party Funds), Profit Sharing, SWBI Bonus (*Wadiah* Certificate of Bank Indonesia), NPF (Non Performing Financing), ROA (Return on Assets) and CAR (Capital Adequacy Ratio) and dependent variable, *mudaraba* financing.

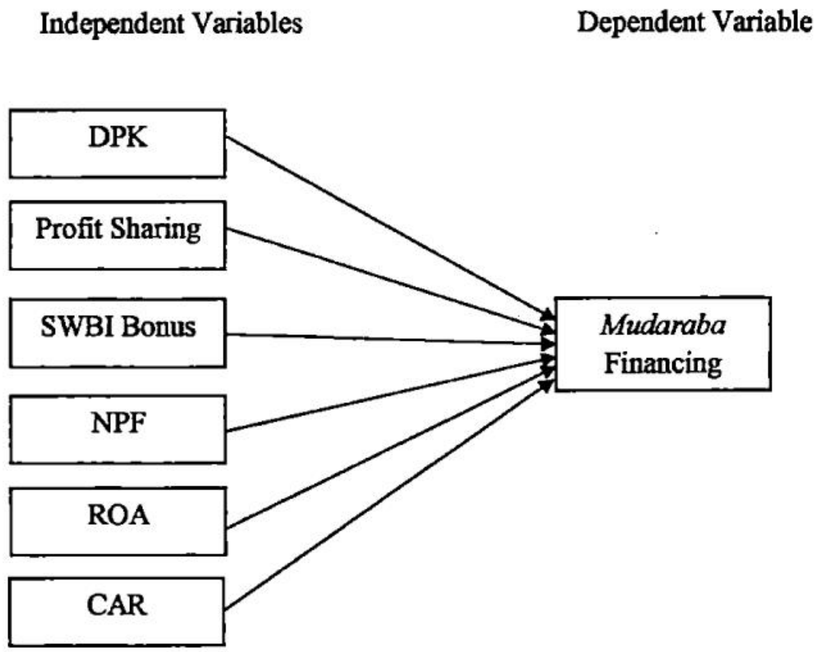

FIGURE 2.1.

A Conceptual Framework Research