

The Third Party Fund and its Impact on Mudarabah Financing: An Empirical Analysis of Islamic Banks in Aceh, Indonesia

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Abstract: This study investigates the impact of third party fund on mudarabah financing in Islamic banking in Banda Aceh, Indonesia. We conducted this investigation using secondary data in the period 2010-2016 which was analyzed using econometric methods. From the results of the investigation, we have found that third party funds have an impact on increasing mudarabah financing. For the sustainability of the Islamic banking system in the future, this banking must be able to provide excellent service to the customer in meeting various needs of sharia-based financial transactions. Thus it is expected that Islamic banking is able to maintain and improve its performance in conducting intermediation activities through various financial services products.

Keywords: third party fund, mudarabah financing, Islamic banking, intermediary, financial services

1 Introduction

The banking sector is the backbone of the country's economy [1], and the current financial situation around the world shows the importance of the banking system and its effects on financial markets and the real sector of the country's economy, as well as minimizing the risk of the banking industry [2]. However, for residents of Islamic countries and countries with predominantly Muslim populations, interest income obtained through savings or investment is prohibited in Islam. Therefore, the presence of Islamic banks in countries with Muslim populations is urgently needed and there must be different economic policies for Islamic countries because religious factors influence the decisions of Muslims, where the interest rate does not affect bank deposits [1] The use of interest in the western banking system is a reason for discomfort in Islamic society to avoid usury which is prohibited in Islam and as an alternative is a need for Islamic banking (Halabi & Mirza (2003); Shibani & De Fuentes, (2017). Bank interest (usury) is one of the main differences between conventional and Islamic financial systems that are the basis of conventional financial systems but are prohibited in Islam (Halabi & Mirza (2003); Shibani & De Fuentes, (2017). Thus, it shows that there is no integrated governance model that can accommodate all levels of society, culture, and

companies; each community has its own social structure and culture, where governance principles are established (Shibani & De Fuentes, 2017).

The Islamic financial system is a promising solution to the current global financial crisis, where (1) the impact of the current crisis on the Islamic financial industry has less impact than conventional financing, (2) investment in Islamic products yields high profits, (3) a portfolio that includes Islamic products reduce systemic risk and produce significant diversification benefits, (4) the US crisis has caused significant changes in resource allocation through changes in investment choices (Arouri et al, 2013). Furthermore, Sukmana & Ibrahim (2017) suggest that Islamic financing is able to withstand the stock market boom/bust cycle or fluctuations, where the existence of Islamic banks under a dual-banking environment is not spared from fluctuations in interest rates or monetary conditions of a country.

In contrast to the findings above, the findings of the latest research proposed by Abdul-Majid, Falahaty, & Jusoh (2017) show that conventional banks are more efficient than Islamic banks. For example, increasing the ratio of net interest margin caused the level of danger in Islamic banks to increase, while the interest rate was lowered in conventional banks [8]. Different treatments are needed in terms of policies to reduce inefficiencies through regulatory and management synchronization for both types of banks as the main implications for policy makers, bank regulators, and industry players. Despite these differences in empirical findings, the Islamic financial system has proven able to withstand the global economic crisis. As an Islamic society, we need to strengthen the basis of this Islamic financial system, by always transacting lawfully with no interest, as instructed by Allah in the al-Qur'an.

Financing in Islamic banking is the provision of facilities to provide funds to the public to meet its financial needs which are unit deficits [9]. One of the financings in Islamic banking is *mudarabah*. In the competitive Islamic banking system, *mudarabah* is seen as an alternative mechanism in financing techniques that distinguishes it from conventional financing which consists of a mechanism of interest that has gone through a various evolution to meet the needs of a rapidly developing Islamic financial market [10]. In addition, based on the results of the study, inflation and profit sharing also did not significantly influence the composition of financing, this implies that Islamic banking must be able to increase deposit funds to increase *mudarabah* financing [11]. As a country with a majority Muslim population, Indonesia has also accommodated the desire of its citizens to provide sharia-based financial institutions through the Law Number 10 of 1992 concerning Banking. At present, the law has been amended by Law Number 10 of 1998 concerning Amendment to Law Number 7 of 1992 concerning Banking. The enactment of the law has become a new chapter for the banking industry in Indonesia base on Islamic principles (*sharia*). In addition, Law Number 21 of 2008 concerning Sharia Banking has also been stipulated. The special law on Islamic banking has become an amplifier for the existence of the Islamic banking industry in the country. Where Islamic banking has had the opportunity to attend and develop to serve the financial services needs of Muslim communities and also non-Muslims who are interested in conducting sharia-based transactions. Aceh as the only province in Indonesia that has been imposed by Islamic law, has also slowly tried to implement Islamic law in various aspects of people's lives, including in its financial system. Where in 2016 a bank owned by the Government of Aceh (Bank Aceh) was converted into a Sharia Commercial Bank (Bank Aceh Syariah). The conversion in addition to meeting the needs of sharia-based Acehese financial transactions has also contributed greatly to increasing the market share of Islamic banking nationally. Based on its function, there is no difference between conventional banks and Islamic banks, as funds collecting institutions from the public and channeling back to the community in the form of financing. But the difference lies in the financial system, where conventional banks

apply the interest system, while Islamic banks apply a profit-sharing system. This article examines the development of third party fund and mudarabah financing, as well as the impact of third party fund on mudarabah financing on Islamic banking in Banda Aceh, Indonesia.

2 Research Methods

The data in this study are secondary data in the form of time series data (from 2010-2016 in the form of monthly data) sourced from the Banda Aceh Bank Indonesia Office. Data processing simple linear regression analysis in this study [12], which is processed by Eviews 9. This analysis was conducted to determine the effect of third party fund on mudarabah financing in Islamic banks in Banda Aceh, Indonesia.

$$Y = \alpha + \beta X + e_i$$

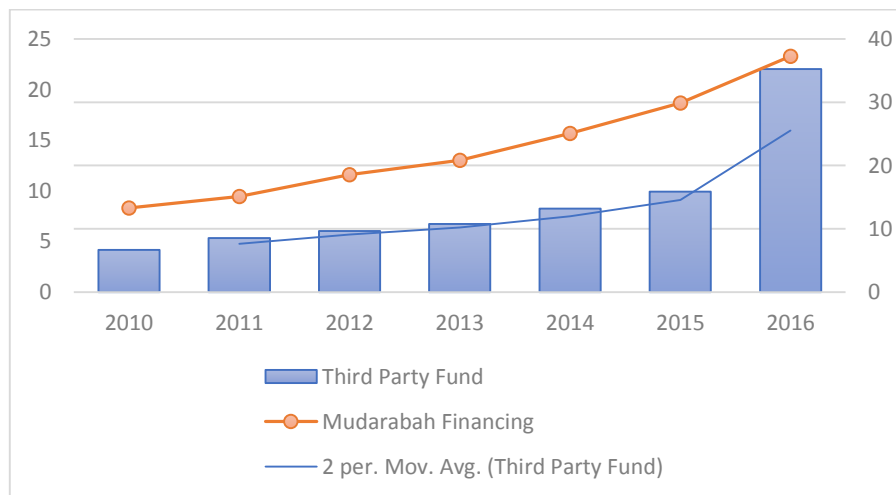
where Y is the dependent variable, α is a constant, β is the regression coefficient, X is the independent variable, and e_i is the error term. Based on the above model, the predictor variable value is then transformed into probabilities with logistical functions, so that this model can be rewritten as follows:

$$MF = \alpha + \beta TPF + e_i$$

where PM is mudarabah financing, TPF is third party fund, and e_i is an error term.

3 Results And Analysis

Based on the results of the research as illustrated in Figure 1, it can be seen that, during the period of 2010 to 2016, third party fund and mudarabah financing in Islamic banking in Banda Aceh, Indonesia tended to increase.



Source: Bank of Indonesia, Banda Aceh Representative Office, Indonesia, 2017

Fig. 1. The Distribution of Third Party Fund and Mudarabah Financing of Islamic Banks in Banda

Aceh, Indonesia: 2010-2016

From the results of the investigations we have conducted, it shows that the proportion of mudarabah financing from year to year increases along with the increase in deposits of third party funds. The higher proportion of third party fund deposits since 2015 was caused by the conversion of the Bank of Aceh into a sharia commercial bank (Bank Aceh Syariah). This can also be seen from the results of data processing using an econometric model, where third party fund has a positive and significant effect on increasing mudarabah financing. The impact of TPF on mudarabah financing in Islamic banking can be explained through the findings of the regression analysis in Table 1.

Table 1. Findings of Regression Analysis Results

Variable	Coefficient	Standard Error	T-statistic	Prob.
TPF	0.037321	0.002735	1.364.628	0.0000
C	146544.3	7.334.568	1.997.995	0.0000
R-squared	0.694282			

The results of the regression analysis above show that the level of trust and interest of the people of Aceh to transact with Islamic banks is very high. Where each year during the observation period, 2010-2016, increasingly shows an increasing trend in the amount of TPF and mudarabah financing. In addition, variations in the variables of TPF in this study can explain 69 percent of the variation in mudarabah financing. Moreover, since the conversion of the Bank of Aceh into a sharia commercial bank in August 2016, TPF and mudarabah financing continued to increase very high. The higher number of TPF has led to an increase in mudarabah financing. These findings are in accordance with the results of investigations conducted by Mutia, Aswadi, & Martahadi (2017) where a third party fund affect the financing deposit ratio (FDR) in Islamic banking. In addition, Mutia, Aswadi, & Martahadi (2017a) also investigate that the majority of the community expressed great satisfaction with the reliability and responsiveness of Islamic banking in Aceh, Indonesia. For the sustainability of Islamic banking, the bank's characteristics and sharia compliance are crucial factors for customers in determining the choice of Islamic banks [15].

4 Conclusion

This study specifically explained the impact of TPF on mudarabah financing in Islamic banks in Banda Aceh, Indonesia. This is indicated by the increase in the number of TPF and mudarabah financing during the observation period, namely 2010-2016. In addition, based on the results of the regression analysis also shows the influence of TPF on increasing the amount of mudarabah financing in Islamic banking. Finally, Islamic banking, both sharia commercial banks and sharia units, must be able to provide the best services to all communities in meeting the needs of various sharia-based financial transactions. This needs to be done so that Islamic banks are able to maintain and improve the achievements that have been achieved so far in raising funds and channeling back to the community through mudarabah financing, and other Islamic banking financial services.

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