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The powerlessness of *mudharabah* instrument in Indonesian Islamic banking

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Abstract: The objective of this study is to analyse the powerlessness of profit sharing payment with the *mudharabah* instrument in Indonesian Islamic banking. The factors that could affect the powerlessness are inflation, interest rate, *mudharib* bankrupt potency (NPF), operational costs, and workload with fixed payment. Using time series data that consist of 60 months from 2014 to 2018, this study shows that the spirit of implementing *mudharabah* contract from the side of financing was excessive as indicated by the constant value 47.750. In the process, it is loosened due to inflation, interest rate, *mudharib* bankrupt potency (NPF), operational cost and workload with fixed payment model. In the future, it is necessary to synchronise the revenue model and cost. If the revenue from the financing side used profit sharing payment model, then all the production costs (wage and rent) should be applied the profit sharing payment model instead of fixed payments.

Keywords: financing; *mudharabah*; profit sharing payments; fixed payments.

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1 Introduction

The profit sharing instrument has become the backbone of the Sharia economy and the main driver of Islamic banking operations as interest in the conventional banking as its main driver (Khaleequzzaman et al., 2017). According to Rahman et al. (2014), profit sharing is the main spirit in the Islamic banking operations. The existence of profit sharing principle is explicitly written in Law number 21 the year 2008 on Islamic banking. Profit sharing would be carried out with either *mudharabah* or *Musyarakah* model of contract. The profit sharing instrument reflects the equity for all parties involved in business transactions through Islamic banking (Usanti et al., 2014). None of the parties could take benefits by sacrificing other parties. Islamic banks are financial institutions that operate people who have extra funds with those who lack of funds. This condition is a manifestation of *ta'awun* (helping each other) in the economic field towards a synergistic interaction that is mutually beneficial according to Sharia. Thus, Islamic banking is the greatest institution to connect the interests of pertinent parties in a just manner under the corridors of humanism and mutual understanding norms. Hence,

Chong and Liu (2009) explain that profit sharing principle is the most important foundation in running the Islamic banking management. This foundation has changed the role of interest that has long been applied in conventional banking.

The implementation of profit sharing instrument in Islamic banking has been widely studied with a variety of results. Generally, the previous studies conclude that *mudharabah* scheme has provided benefits to the Islamic banking industry. Obeidat et al. (2013) found that financing variables based on the profit sharing contract give a positive effect on Islamic banking profits. This finding has been confirmed by Almanaseer and Alslehat (2016).

Khan and Mohamed (2017) underlines that profit sharing (profit and or loss) is the best financial method based on the perspective of Islamic economic law. Profit sharing also became the identity of Islamic banks. The high success of funds accompanied by financing management based on profit sharing cooperation is indeed able to foster good financial governance of Islamic banking without increasing the financial risks of the banks.

However, in practice, financing with *mudharabah* instrument just becomes a small part of the Islamic banking in almost every country (Noormahinar et al., 2019). This phenomenon also occurs in Indonesia and instead the banks turn to *murabahah* instrument. The productive business is often used in the *murabahah* contract. Practically, the use of *mudharabah* scheme in Sharia commercial banks is 35.22%, and in the Sharia rural banks is 11.61%. From the financing side, the average of all Islamic banks is 23.41% (Financial Service Authority, 2018).

The discrepancy between the ideal conditions and the existing reality indicates that the profit sharing payment has not become the prima donna on the financing side for Indonesian Islamic banking institutions. Islamic banks tend to prefer *murabahah* instrument which is considered to provide the certainty profit as interest in conventional banks.

Shofawati (2014) found that the distribution of Islamic banking in Indonesia is still dominated by *murabahah* scheme. According to the bank's perspective, *murabahah* scheme will provide a guaranteed level of profit with a relatively lower risk. Lathif (2012) concluded that the *murabahah* sale and purchase scheme is the most dominant financing instrument in the Islamic banks with three application models. The first type is consistent with *fiqih muamalah*. In the second one, the bank pays the fund directly to the sales agent, but the transfer of ownership rights to the customers is carried out directly by the sales agent. The third type refers to the condition where the Sharia bank and the customer enter into a sale and purchase contract (*murabahah*) and at the exact time the Sharia bank gives a representation of the purchased goods to the customer. Based on its practicality calculation, the second and third models are the most commonly used. While the first model which is considered as the most ideal type according to *fiqih muamalat*.

Komijani and Taghizadeh-Hesary (2019) explain that the financing portfolio of newcomers of Islamic banks is dominated by *murabahah* scheme application. This is because the *murabahah* scheme gives more secure reason and profit certainty. The reason is because the financing funds are derived from investments/deposits/savings of the public, while the profits from the financing with *mudharabah* contract are unpredictable. On the other hand, *mudharib* often demonstrates moral hazard by making invalid business financial statements. Therefore, Islamic banks are unwillingly to take risk however small it is.

Studies on the dominance of *murabahah* instrument in the financing transactions of Islamic banking have been done with qualitative findings. The qualitative findings mentioned previously can be identified as external micro, macroeconomic factor, and also as internal. The interest rate as the substitute for profit sharing has become the driving factor of price level fluctuations, and inflation as the driving factor of uncertainty in economic conditions has become the macroeconomic factor. Whereas, non-performing financing (NPL/NPF) as a reflection of the stability of the business condition of *mudharib* has become the external microeconomic factor. On the other hand, the workload (fixed payments) systems have become the internal variables of Islamic banks. In order for these findings are measurable and can be utilised as the policy materials, quantitative research needs to be conducted.

This study focuses on analysing the influence of the five variables mentioned earlier towards the powerlessness of *mudharabah* instrument on the financing system of Islamic banks in Indonesia.

This study contributes to the Islamic banks that using *muharabah* instruments, especially inflation factors, interest rates, the potential bankruptcy of *mudharib*, labour and operational costs. In addition, this study also contributes to the development of Islamic bank literature, especially related to the management of *mudharabah* financing which is still relatively limited

2 Literature review

2.1 Islamic banks

Soewarno and Ali (2016) state that the banking sector is considered as the most regulated industries. Banks are the only financial institution authorised to create cash through the central bank. Bank as the only depository financial as a fund collector in the form of savings, demand deposits, and deposits from the public (Werner, 2014). The funds collected are distributed to people who need credit. This process supports the effort in achieving public welfare.

The activity of collecting and distributing funds from and to the public conducted both interest and profit sharing based on banking institutions. The first is known as conventional bank and the second is called Sharia bank (Marchetti, 2014). In conventional banks, all activities of collecting and distributing funds are based on interest instruments. The nominal profit obtained is set at the beginning of the transactions. Whereas, all activities of Islamic banks, both in terms of collecting and distributing the funds are based on profit sharing. The nominal profits earned by *shahibul maal* or *mudharib* will be received after the real economic activities are done. The only certain things show at the beginning is *nisbah* (percentage) of profit or loss between the two parties of *shahibul maal* and *mudharib*.

The establishment of Islamic banks is based on the following responsibilities: first, to build a strong Sharia financial industry based on fairness, efficiency, and able to encourage the growth of the economic business community (Khaled, 2015). Second, to increase the quality of socio-economic life by encouraging the creation of new job opportunities and an increase in people's income broadly. Third, to encourage community participation in economic development activities, especially in the financial

sector (Mardian, 2015). Fourth, to lead the community to think economically and run a business based on the Sharia economy (Ahmad et al., 2015).

Islamic bank operates within the principle of fairness, partnership, and *falah* orientation. The principle of fairness refers to the distribution of profits that is conducted based on the actual activities done by their respective entrepreneurial roles, not based on interest calculations, and does not monopolise each other. Interactions between investors (*shahibul maal*), fund users (*mudharib*), and financial institutions are equal and mutually beneficial. Interactions are also carried out to form a business partnership to achieve reasonable and halal profit. *Falah* orientation refers to the economic activities of Sharia financial institutions that are not solely profit-oriented, but also the spirit of blessing (Mohammad and Shahwan, 2013). Therefore, it also prioritises the halal commodities, non-usury transaction processes, and do *zakat* from the results of transactions.

The fundamental role of Islamic banking as a business institution (*baitul tamil*) and a social institution (*baitul maal*) that are inherently interdependent (Wan Jusoh et al., 2015). As a business institution, Sharia bank has three different functions at once: as an investment manager, investor, and as a service provider. As an investment manager, Islamic banking works to collect public funds with *mudharabah* contract and others. As the investor, Islamic banking distributes funds to the public based on *mudharabah*, *murabahah* (sale and purchase), and *ijarah* (rent) contract. As the service provider, Islamic banking offers circulation services of financial and non-financial payments and also agencies.

Funds that have been collected through the principles of *mudharabah*, *Wadiah*, etc. recorded as fundraising. The fundraising is utilised for financing purposes based on *mudharabah*, *murabahah*, or *ijarah* contract (Rahman et al., 2014). All revenues that come from the financing are shared with the bank and the depositor with the number according to the initial contract. The portion of profits received by the bank is written in the profit and loss record and becomes the main operating revenue.

The allocation of bank funds is to get the maximum level of profits while maintaining public trust through constantly secure liquidity (Addillah et al., 2016). The combining of these purposes is important. In consequence, the allocation of all funds remains managed effectively and efficiently. The allocation of Sharia bank funds refers to two basic entities, the non-producing assets (non-earning assets) and earning assets. Non-earning assets comprise primary reserves for the benefit of cast ratio and utilisation of funds in the form of fixed assets and inventory. The earning assets include secondary reserves which aim to maintain liquidity as well as profit purposes through short, medium and long-term financing (Alshatti, 2014).

2.2 *Profit sharing theory (profit/loss sharing)*

Based on the perspective of Islamic economy, bank interest is a category of usury and haram. This has an impact on the emergence of new instruments, namely profit sharing. This instrument is actually not entirely new but in its application in the banking sector, it is relatively new. The prohibition of the use of money interest in economic activities is because it does not reflect the standard of fairness. According to Sheng (2013), the unfairness is seen in the discrimination on the distribution of risk and profit possibilities for parties involved in business cooperation. All parties involved in business cooperation should bear losses that may arise. All the parties should also receive profits that may be acquired together based on the portion of their entrepreneurial roles. Hence, Hanif (2014)

underlines that in business cooperation with profit sharing contracts as to the foundation there is no certainty of results as when using the interesting instrument. The amount of profit is determined by its actual productivity in the business activities.

Meticulously observed in modern business activities, the use of profit sharing is a common practice that has been implemented for a long time. Capital equity in shares in various companies is a concrete example. Shareholders will receive dividends as part of fluctuating business profits. If there is a loss in the business activities undertaken, the shareholders will jointly bear the losses based on the percentage of their equity participation.

The calculation of capital price with profit/loss sharing model must be carried out jointly with the entrepreneurial roles of all parties that establish business cooperation. Both of which are inherently interdependent in deciding the amount of price of production factor. Business activities can run because of the involvement of all production factors, including capital (money) in actual productivity. In the Sharia economy, the rise in profits comes from the actual activities driven by capital. If the money is not utilised for real business activities, it certainly will not make profits. According to the Sharia economic point of view, the money will not raise if it is not used for real business activities.

The rise of profits on business activities based on *mudharabah* contract refers to the size of percentage (instead of absolute nominal value) of the possibilities of actual productivity (Swartz, 2013). The absolute value that is completely received can only be obtained after the real business activities have been performed and for the amount of *nisbah* is agreed upon the agreement made by those involved at the time the activities about to run. The amount of *nisbah* is highly influenced by the contribution of each party in the business participation and the expected profit obtained and also the calculation of possible risks that may occur. The model specification can be formulated as follows:

$$Y = f(C, P, R) \tag{1}$$

information

Y profit sharing

C contribution of participation in business

P expectation of profit obtained

R calculation of possible risks.

The factor of participation contribution in business is measurable and visible. Therefore, this factor does not require any special analysis. Whereas factor P (expectation of profit obtained) and R (calculation of possible risks) require special analyses. Expertise in estimating profits and risks that may arise in business cooperation on the basis of *mudharabah* contract is crucial, especially for the occurrence of risks possibilities throughout the business activity. The occurrence of risks sometimes because not considering the data accurately.

Awareness of possible risks is crucial because the risks may negatively affect business activities and will reduce the value of business profits. The accuracy in calculating the probability of profits gain requires careful analyses of risk variables. According to McGoun (1995), risks can be classified into: first, the occurrence is likely to have historical precedent and thus the possibilities can be estimated for every outcome

that may arise. Second, the occurrence can be unique, without any similar event that happened in the past but still has the possibilities to occur in the cause and effect logic. Third, extreme events that never been thought before.

In this study, the risk is defined as a probability of an event that owns a historical connection and is subject to probability distributions. Hence, the occurrence of risk can actually be estimated, at least theoretically. Risk is defined as all uncertain events that may happen in the future and divide them into two types (Al-sultan, 1999). First, it refers to a risk that the occurrence only relies on fortune alone. There is no reference even little to be able to answer and calculate the possibilities of future events. A person can only be passive. This condition is often called 'game of chance'. Second, the occurrence of the event has a causal explanation through probabilistic distribution and is based on skill. This risk occurrence is often referred to as 'game of skill'.

Revenue on profit sharing by using *mudharabah* instrument is not speculative. It is due to the occurrence is predictable through logical causal explanation, and based on skill. Risks that may occur along with the raise of profits can also be estimated and possess historical events. In business activities, the risk is the other side that is owned by profit and cannot be avoided. In the Sharia transactions, both of these possibilities are equally charged to the parties involved in the cooperation, either the *mudharib* or *shahibul maal*. There is no condition where one party receives the profit, while the other party only receives a loss. Thus, in *mudharabah* transactions, it is not a win-lose solution but a win-win solution.

Conventional transactions with interest base are a win-lose solution. When one party receives a profit, the other party will definitely experience loss. It is because the process of activity is a game of chance. Thus, the business cooperation established on the basis of the interest system is categorised as *gharar*. It is normal then is there are some Muslim individuals and/or groups whatever high and low the interest rates will not affect their choice in savings and/or financing requests in Islamic banks (Awan and Azhar, 2014).

3 Hypotheses development

3.1 Inflation and financing and mudharabah instrument

Inflation can adversely affect the economy and trigger uncertainty of macroeconomic conditions in a country (Barro, 2013). The higher prices and the constant income of the society will affect decreasing the public ability to save some of their income for saving. In the business sector, inflation drives production costs (workload, capital cost, building rent) going up, and impacts business activities tend to be disturbed and even stop (Mohseni and Jouzaryan, 2016). The ability of the producer to repay the credit or financing capital to the bank is also disrupted.

This condition is exacerbated by the application of a fixed payment system for production factors, including in the sector of the financial industry. When income is decreasing, the producer still has to disburse the production factor constantly according to the initial agreement. It will be different if using the profit sharing payment scheme; factor costs will go up and down in accordance with the ups and downs of the income.

On the other hand, inflation is a potential trigger for the increase in loan interest. The high movement of loan interest rates is the potential to hamper the growth of credit quantity for the banking industry, and that will make the income to decline. Inflationary

movements in the community that implements a dual banking system like in Indonesia will affect the decline of the Islamic banks' profits. The inflation increases and interest rate will trigger the increasing number of bad financing. Errouaki (2014) states that inflation has a negative and significant effect on corporate profitability. It can then be hypothesised:

H_1 The inflation rate gives a negative effect on *mudharabah* financing in Islamic banks.

3.2 *Interest rate, financing and mudharabah instrument*

The policy of a high increase in interest rate to overcome inflation has resulted in stringent banking liquidity and tended to kill economic activities (Cukierman, 2013). For Islamic banks, this condition is the potential to cause a higher number of bad/non-performing finance (NPF). When the credit interest rate rises, the value of the business outcome of *mudharib* disproportionate to the value of credit/finance received. If a customer is felt a heavy burden by the high credit interest rate, the bad/NPF will tend to increase. This analysis leads to a hypothesis:

H_2 Interest rate has a negative effect on *mudharabah* financing in Islamic banks.

3.3 *NPF and financing with mudharabah instrument*

Financing is always employed as the primary activity of Islamic banking and non-Islamic banking. Financing diction has the same understanding as credit diction. Not a few of modern banking dictions derive from the *fiqih* vocabularies. Financing dictions are taken from the terms *qard* (Arabic) and *credo* (English). *Qard* means lending money and *credo* means trust. Thus, *qard* means lending money on the basis of trust.

Financing is a risky asset owned by Islamic banks (Srairi, 2013). Mufraini et al. (2020) find that the is such a strong spatial influence on Islamic bank financing. Hence, Islamic banks ne to maintain and secure it so they can avoid the possibility of suffering from losses. Supervision needs to be done in order for the financing given can be properly maintained (Farook et al., 2014). Financing supervision can be carried out to the internal of the bank, particularly in the administration and implementation of the financing as well as to the *mudharib* as the recipients of the financing.

At the time *mudharib* is running a business with the financing funds received, problems to occur is always possible. The occurrence of a problem may be because of the incapability of *mudharib* to handle it or because a mistake in prediction by the management. This condition results in the inability of *mudharib* to return the capital given, either the full number or some. For the Sharia bank, this reality will cause bad financing issue or *NPF*.

NPF reflects financing risks in all banks (Havidz and Setiawan, 2015). One indicator of the low quality of Sharia bank financing is depicted by the higher ratio of NPF. The problem is because financing is the biggest source of income for Islamic banks. Thus, the healthy enough financing condition greatly affect the bank profits.

The increasing bad financing cases have caused the opportunity losses to profit from the financing distributed. This reality will give an impact on the decreasing profit income that will adversely affect the sustainability of a bank. The study by Abusharbeh et al. (2013) conclude that bank profits are influenced negatively and significantly by NPF

variable, Whereas asserts that financing offers with profit sharing model in Islamic banks are not significantly affected by NPF (Sholikhah et al., 2017).

H_3 *Mudharib* bankruptcy potency (NPF) gives a negative effect on *mudharabah* financing in Islamic banks.

3.4 Workload and financing with mudharabah instrument

The number of workers has a positive potential for company productivity (Börsch-Supan and Weiss, 2016). This condition occurs when the total wage of labour is still below the total income of the company. Labour costs in Islamic banks use the flat payment model. Total wages in a given period are known. However, company revenue (Islamic banks) cannot be known with certainty because the basis of revenue acquisition with profit sharing payment models contains uncertainty. This condition causes the *mudharabah* financing model to be avoided by Islamic bank management (Al Rahahleh et al., 2019). Analysis of the literature above gives birth to a hypothesis:

H_4 Number of workforces has a negative effect on *mudharabah* financing in Islamic banks.

3.5 Operating cost and financing with mudharabah instrument

The sustainability of financing provided to *mudharib* for an Islamic bank is very dependent on the benefits obtained (Chowdhury and Farooque, 2016). While profits are derived from the difference between the surplus of income and costs incurred (Chun and Ovchinnikov, 2019). All this time, the costs for building/land rent, etc. that is spent by the management of the Islamic bank are in the flat (fixed payment) model. While the financing transaction is used the profit sharing payment system. This condition certainly does not show the synchronisation of financial flows. This policy has the potential to cause losses to the management of Islamic banks. For example, a simulation of operating expenses for a particular year is set at Rp.20 billion. Whereas in the same year, there was no certainty regarding the amount of income due to the use of the profit sharing payment model. Conditions can appear less, the same, or greater than the figure of Rp.20 billion. This becomes a great concern to the management of Sharia banks and has strengthened the concerns on the *mudharabah* ineffectiveness in financing transactions. Literature analysis above gives birth to a hypothesis:

H_5 Operational costs with flat (fixed payment) model give a negative effect on *mudharabah* financing in Islamic banks.

4 Research methods

4.1 Sample and data

The population in this study was Indonesia Islamic banks that registered in the Financial Services Authority (OJK). This study used secondary data from 60 observations which are monthly aggregate data of Islamic banks in Indonesia during the period 2014–2018. Data provided by Islamic commercial banks in Indonesia.

4.2 Definition of operations and variable measurements

The variables of this study consisted of endogenous and exogenous. The endogenous variables are *mudharabah* (Y) financing percentages. While the exogenous variables consist of inflation ($X1$), Bank Indonesia interest rates ($X2$), *mudharib* bankrupt potency ($X3$), labour ($X4$) and operational costs ($X5$). The variables used in this study explained with Table 1.

Table 1 Operational and measurement of research variables

Variables	*Symbol*	*Definitions*
Mudharabah financing	Y	The aggregate amount of *mudharabah* financing provided by Islamic banks
Inflation rate	$X1$	Monthly inflation score from Bank Indonesia
Interest rate	$X2$	An interest rate score from Bank Indonesia
Mudharib bankruptcy potency	$X3$	Indonesian Islamic bank aggregate non-performing financing score
Number of workforces	$X4$	Total labour wages
Operating costs	$X5$	Total aggregate operational costs of Indonesian Islamic banks

4.3 Data analysis

To analyse the data, this researcher used a multiple linear regression model, formulated as follows:

$$Y_t = \alpha + \beta_1 X1_t + \beta_2 X2_t + \beta_3 X3_t + \beta_4 X4_t + \beta_5 X5_t + \varepsilon \quad (2)$$

where

Y_t financing with *mudharabah* instrument

α constant

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$ coefficient of independent variable regression $X1_t, X2_t, X3_t, X4_t, X5_t$

$X1_t$ inflation rate

$X2_t$ Bank Indonesia interest rate

$X3_t$ *mudharib* bankruptcy potency

$X4_t$ number of workforces

$X5_t$ operating cost.

5 Result and discussion

This study used multiple linear regression to examine the effect of the inflation rate, Interest rate, *mudharib* bankrupt potency, number of workforces, and operating cost on *mudharabah* financing in Indonesian Islamic banks. Data analysis test results are presented in Table 2.

Table 2 Data analysis test results

Variables	*B*	*T*	*Sig.*
Constant	47.750	6.619	0.000
Inflation	0.784	1.283	0.204
Interest rate	–1.246	–1.925	0.058
Mudharib bankruptcy potency (NPF)	–3.196	–14.888	0.000
Workforces number	–2.596	–3.417	0.001
Operating costs	–0.131	–5.194	0.000
Goodness of fit	0.873		
F-test	95.411		0.000

Table 2 shows the values of all variables below 5%, except inflation. This result shows the correlation between inflation and financing options with profit sharing instruments is not convincing enough. Table 2 also shows that among the predictor variables are examined linearly through coefficient analysis.

The constant score is 47.750 with a positive direction (+) shows, in the beginning, *hirroh* (spirit) of Islamic banking players in Indonesia to implement the *mudharabah* instrument scheme on the financing agreement is relatively strong already. This condition illustrates the idealism of Islamic banking players to operationalise the Islamic banks according to the sharia brand as their main driver is high. This finding is worth believing because the error rate is below 5% (0.000).

The score of inflation coefficient is 0.784 with a positive direction (+) indicates that by the time inflation is on the rise, the financing offers with profit sharing will increase. This finding is relatively different from the logic of economic theory which states the opposite when the inflation raises the financing offers with profit sharing contracts should be declining. Why does the finding directly proportional? Because inflation caused an increase in demand, not because of the increase in production costs (cost push inflation). However, this finding is not sufficiently reliable since the error rate is more than 5%, up to 20.4%. Coefficient 0.784 indicates the response of the increase in financing with profit sharing towards the rise of inflation is inelastic, less than 1.

The coefficient of interest rate variable is (–1.246) with a negative direction (–) state that when the interest rate increases, financing offers with revenue agreement of Islamic banks tend to decrease. The operations of Islamic banking actually do not have any connection with 'interest'. Nevertheless, the movement of the ups and downs of interest rates will have an impact on the existence of Islamic banking. This condition is due to Islamic banks are capable of becoming substitute goods and or complementary goods for conventional banking.

Economic logic asserts that when the benchmark interest rate rises, demand for savings in the Islamic banks will decline. On the other hand, it gives an impact on the increasing public demand for Sharia bank financing. Can we say that these findings have gone off the economic logic track? If seen from the demand side, it can be classified as out of the economic logic. But, from the offer side, this condition is said to be reasonable. This is because the Islamic banks will calculate the investment possibilities of *mudharib* who move to Islamic bank sources will experience potential constraints in gaining profits in the situation of high interest rates. These types of conditions have the potential to

generate high NPF scores. Statistically, this finding is reliable for the significance value is around 5%, which is at 5.8.

The coefficient of bankrupt potency (NPF) variable is (–3.196) in a negative (–) illustrates when the bankrupt potency of *mudharib* increase, financing offers of Islamic banks with profit sharing contract tends to decline. The potential of bankruptcy is marked by the obligation of debt installments of *mudharib* which are getting stagnant and even default. The defaults in returning financing obligations will certainly give an impact on the company's income and profits. Income and profits will be used by the company for expenses of operating costs (workforces wage) and non-operating with flat (fixed payments) model. This finding fits the economic logic and is reliable since its significance level is less than 5%.

NPF describes financial risk. When the NPF ratio is high, then the quality of a financial Sharia bank is worst. Because of the function of financing as the greatest contributor to the profit for Islamic banks, it is necessary to have financial management. The level of NPF also influences bank profits achievement (Abusharbeh et al., 2013). The increase of NPF will result in a loss of opportunities to obtain revenue from the financing provided. This condition will influence the profitability and adversely impact on the sustainability of a bank. This finding is consistent with Faiz (2010) who concludes that NPF has a negative significant effect on bank profits. However, it is different from a research done by Addillah et al. (2016) which found that NPF provides an insignificant impact on *mudharabah* -based financing volume in Indonesian Islamic banking.

The coefficient of variable of workload (–2.596) with a negative direction (–) explains that when the number of workforces increases, the financing offering of Islamic banks with profit sharing agreement tends to decrease. This finding is strongly reliable because statistically, it shows a significant number below 5% which is 0.001. The perspective of economic logic emphasises this finding. Workforce wages of Islamic banking are almost entirely paid by flat (fixed payments) system. This fact certainly gives an impact on the Islamic bank burden to always pay at the flat (fixed payments) regardless of income received. Income is received from the results of *mudharib* activities that have utilised the Islamic banking financing. When the *mudharib* business activities are being disrupted, the profits of Sharia bank as *shahibul maal* are low. If this phenomenon does happen and is under the burden of obligation to pay the workforce wage, the concern is the emergence of negative spread conditions and impacts on bankruptcy. This possibility encourages Islamic banks to prefer to keep away from financing instruments with profit sharing instruments.

The coefficient of operating costs variable is (–0.131) in a negative direction (–), it shows that when the operating costs increase, financing offers with profit sharing contract of Islamic banks tends to decline. This finding is highly reliable since statistically shows a significance score under 5% which is 0.000. The logic of this result is similar to the workforce number variable.

The findings which have been elaborated toughen the sense of mistrust of the Islamic bank managers to implement the spirit of the *Sharia* economy, *mudharabah*, on the financing side. In this finding, Warninda et al. (2019) even affirms that the growth of profit-sharing financing with *mudharabah* and *Musyarakah* contract models is not only unable to increase the profits but tends to decrease the profits instead. The application of profit sharing on financing is considered full of risks. Risks of *mudharabah* financing as stated by Rodoni and Yaman (2018) in which one of the parties takes more dominance in controlling information about business conditions that prompt to act dishonestly.

Secondly, the utilisation of financing funds by customers is not in accordance with the agreement. Thirdly, *mudharib* often neglects to control the management and make mistakes deliberately.

6 Conclusions

This study examines the effect of inflation, interest rates, *mudharib* bankruptcy potency (NPF), labour, and operational costs on *mudharabah* financing in Islamic banks. This study finds that interest rates, NPF, labour, and operational costs influence on *mudharabah* financing. However, this paper is unable to prove the influence of inflation on *mudharabah* financing. The strongest influence on not to use profit sharing instruments decision in the financing sector is the *mudharib* bankruptcy potential factor and labour costs. These two factors causing the manager to concern about the emergence of negative spread conditions, where the expense is greater than income.

From this study, we provide recommendations that it is necessary to have *mudharib* financial management assistance. The purpose of this policy is to encourage *mudharib* to become accustomed to record the income and expenditure flows in accordance with actual activities and also to anticipate moral hazard actions. Need to change the payment model for all factors of production from the flat payment model (fixed payments) to profit sharing payment as applied to the payment of profit of third party funds (*shahibul maal*). The factors that need to be changed are payment of labour wages and payment of rental premises. This policy is in the context of synchronising revenue and expenditure flows. If the income side uses the profit sharing instrument, then the expense expenditure is also consistent using the profit sharing instrument. The idea of applying the profit sharing payments model to labour costs and renting a place/building is likely to crash into the 'big wall', which is the habit of the people who already feel comfortable with the use of the fixed payment model.

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