El-Aswaq
Vol. 6, No. 1, 2025
E-ISSN: 2745-4266

FACTORS INFLUENCING THE FINANCIAL PERFORMANCE OF ISLAMIC RURAL BANKS IN INDONESIA

Hamdi Agustin[1], Lathifa Miftahul Jannati Hamdi[2], Luthfia Ahluljannati Hamdi[3]
[1]Universitas Islam Riau, Indonesia
[2,3]Sekolah Tinggi Dirasat Islamiyah Imam Syafi'I Jember, Indonesia
kembar110703@gmail.com

ABSTARCT

The purpose of this research is to determine the factors influencing the performance of Islamic rural banks in Indonesia. This study is an attempt to explore the implications of the COVID-19 pandemic for the banking industry in Indonesia. As we know, banks in developing countries are more vulnerable to these external and massive threats. Therefore, it is very important to study their performance in the era before and during COVID-19, The population of IRB in this study were 163 companies. Because the data was incomplete and not available on the company's website, the sample could not be taken from all populations. so that there are 74 data that meet the criteria for being sampled because they have the most complete financial reports and have been published in the 2018-2021 period. The results of the study show that the dummy variable COVID-19 has no effect on the financial performance of Islamic Rural Banks. COVID-19 has not had an impact on IRB performance due to the segmentation of IRB consumers, mostly rural communities who have income from agriculture, plantations, and trade. These efforts did not have an impact on reducing the income of IRB consumers during the COVID-19 period. Thus, COVID-19 will not have an impact on the financing that has been distributed by the IRB. OCOI and SIZE variables affect financial performance. Meanwhile, the CAR, FDR and NPF variables have no effect on the financial performance of Islamic Rural Banks.

Keywords: npf; roa; size; Covid-19

INTRODUCTION

The consequences of COVID-19 for the banking industry in developing countries could result in major problems. Due to COVID-19, there was a large increase in the number of people who default on loans, withdrawals difficulties, clients withdrew funds in savings to support basic needs, the decreased amount of funds loan reserves, and declining demand for new investment (Lagoarde-Segot & Leoni, 2013; Su et al., 2020a, 2020b). Although banks are considered as a tool for growth in any economy, their importance in facilitating the activities of emerging and developing economies has increased manifold due to the role of banks as providing capital financing in both the short and long term (Rizvi et al., 2020b). The role and influence of banks is enormous, especially in countries where financial regulation is immature due to weak or non-operating security markets, a lack of effective and tolerable legal regulation, an absence of contemporary and important financial instruments, and the novelty does an inadequate part (Barua, 2020). In addition, on developing countries, banks are very important to intensify economic growth. If a bank is in a high-risk condition, the process of utilizing existing funds in the bank will be significantly hampered (Naqvi et al., 2021; Umar et al., 2021a). As a result, the economic development in developing countries will be suffering (Xie, et al., 2022).

Various literature highlighting the potential implications of COVID-19 for banks have been carried out in both developed countries (Cecchetti & Schoenholtz, 2020) and developing countries (Barua & Barua, 2021). During the COVID-19 pandemic, the conditions in the banking sector were very vulnerable because many debtors from various industrial sectors were affected by COVID-19, so they experienced problems in carrying out their obligations (Cecchetti & Schoenholtz, 2020). This will certainly have an impact on bank performance. However, in this condition, banks are still required to continue to provide good performance because they remember their important role in carrying out the intermediary function in various industrial sectors (Hartadinata & Farihan, 2021).

This study contributes to the literature in the following aspects. First, prior literature examined the impact of COVID-19 on macroeconomic prospectives, such as economic growth (Apergis and Apergis, 2021), International Trade (Gruszczynski, 2020; Vidya and Prabheesh, 2020), oil price (Mensi et al., 2020; Gharib et al., 2021), and gold price (Mensi et al., 2020). While at the firm level, most existing studies focus on the impact of COVID-19 on a firm's performance (Fu and Shen, 2020; Gu et al., 2020; Shen et al., 2020; Xiong et al., 2020; Škare et al., 2021) and stock market returns and volatility (Al-Awadhi et al., 2020; Baek et al., 2020; Zaremba et al., 2020; Harjoto et al., 2021). At the same time, the impact of COVID-19 on bank performance is scarce (Xiazi and Shabir, 2022).

Understanding the financial performance of all Islamic Rural Banks (IRB) in Indonesia is necessary (Wasiaturrahma et al., 2020). This is because several previous studies separately analyzed BPR and IRB, such as Muhari and Hosen (2014), Hartono et al. (2008) and Septianto and Widiharih (2010). Researchers who examined the impact of COVID -19 on Islamic banks in Indonesia are Ichsan et al (2020), Azhari & Rofini (2020), Hasan (2020), Efendi & Harian (2020), Tahlina (2020), Ilhami & Thamrin (2020), Fitriani (2020), Rahmawati et al. (2021). Meanwhile, research specializing in the performance analysis of Islamic Rural Banks in Indonesia has been very limited.

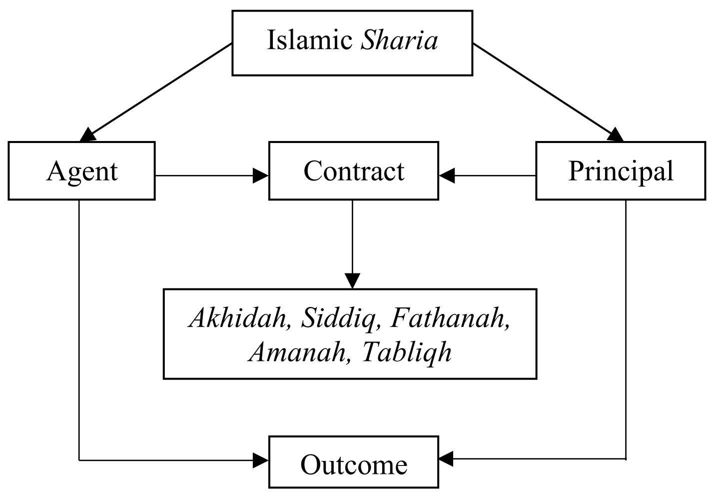
To our knowledge, empirical evidence on the impact of the pandemic on banking sector performance is also insufficient. To date, there is not a single empirical study that has looked at the impact of the COVID-19 pandemic on the performance of the banking sector. From the studies that have been carried out, it turns out that there is still limited research on the impact of COVID-19 on the Islamic Rural Banks in Indonesia. Therefore, this study contributes to analyze the influence of COVID-19 on the performance of Islamic rural banks in Indonesia. This paper attempts to identify the impact of the COVID-19 pandemic and the financial performance of Islamic Rural Banks in Indonesia. This study is an attempt to explore the implications of the COVID-19 pandemic for the banking industry in Indonesia. As we know, banks in developing countries are more vulnerable to these external and massive threats. Therefore, it is very important to study their performance in the era before and during COVID-19, especially in Islamic Rural Banks in Indonesia. The findings in this study offer valuable implications for banking sector regulation in Indonesia.

BASIC AND DEVELOPMENT HYPOTHESIS

IRB is one of the Islamic banking financial institutions, whose operational pattern follows sharia principles or Islamic muamalah. IRB was established based on Law no. 7 of 1992 concerning government regulation (PP) No. 72 of 1992 the bank is based on the principle of profit sharing. In article 1 paragraph 4 of Law No. 10 of 1998 concerning changes to Law no. 7 of 1992 concerning banking, it is stated that IRB are banks that carry out business activities based on sharia principles which in their activities do not provide services in payment traffic. Before being referred to as Islamic Rural Bank (IRB), it was also called At-Tamwil As-Sya'bi Al-Islami, namely a bank that conducts business activities conventionally or based on sharia principles which in its business activities do not provide services in payment traffic. Law Number 21 of 2008 regarding sharia banking defines sharia credit banks as Islamic rural banks.

Guidelines for the relationship between owners and management are based on Agency Theory in Islamic Perspective. Figure 1 shows Islamic sharia is a guideline for principals (owners) and agencies (management) in cooperating with companies. Thus, all actions and policies of principals and agencies must be based on Islamic sharia. The principle of agent contract in the Islamic perspective is based on the ASIFAT concept, namely: *Akhidah* (obedience to Allah Ta'ala), *Siddiq* (true), *Fathanah* (intelligent), *Amanah* (honest/trustful) and *Tabligh* (communicative).

Figure 1: Agency Theory in Islamic Perspective



Source: Agustin et.al. (2020)

Basically, IRB are banks that carry out business activities based on sharia principles where their activities do not provide services in payment traffic as in commercial banks. Intermediation is carried out in the form of raising funds from parties who have excess funds to parties who need funds. IRB as Islamic financial institutions can provide financial services equal to Islamic commercial banks. In Indonesia, the development of Islamic banking is based on two considerations. The first is that the market coverage is very large in Indonesia, where consumers choose not to use conventional bank services because they prefer to follow sharia rules. Second, namely the Islamic banking system as an alternative that can be implemented as a restructuring program with the help of the Indonesian government's initiative.

Islamic Rural Bank (IRB) as one of the Islamic banking financial institutions, whose operational pattern follows sharia principles or Islamic muamalah. Islamic people's financing banks were established as an active step in the context of restructuring the Indonesian economy as outlined in various financial, monetary and banking packages in general, and specifically to fill opportunities for conventional bank policies in setting interest rates (rate of interest). widely known as profit-sharing banking system or Islamic banking system.

The COVID-19 pandemic has caused income from disbursing financing to decline. One of COVID-19 downfall is people still must make expenses while the income itself has just going down caused by declining in sales activities. In Indonesia, the spread of the Corona virus has weakened the performance and capacity of Islamic banks, especially debtors. The weak performance of debtors can increase the risk of financing which will disrupt banking and the financial stability of Islamic banking. COVID-19 has become the focus of great attention for the State of Indonesia because of the problems it continues to cause, there are many losses due to COVID-19 which have an impact on the Indonesian economy. The economic development of a country basically aims to achieve social welfare through rapid economic growth and fair distribution of income. During the COVID-19 pandemic, the economy was hit, all businesses experienced a slowdown, including IRB.

RESEARCH METHODS

The object of this research is IRB that has been registered with the Financial Services Authority (OJK) and has financial data for 2018-2021. The sampling method is based on a purposive sampling method based on a technique based on certain criteria. The population of IRB in this study were 163 companies. Because the data was incomplete and not available on the company's website, the sample could not be taken from all populations. so that there are 74 data or 296 observations that meet the criteria for being sampled because they have the most complete financial reports and have been published in the 2018-2021 period. The dependent variable used in this study is the Return on Assets (ROA). Following past studies of Sufian and Habibullah (2009) and Sufian and Noor Mohamad Noor (2012), Agustin et al. (2018), Fajri et al. (2022), Hassan et al. (2022) we used bank performance as a dependent variable that is a proxy of return on asset. COVID-19 is a dummy variable for the time period since COVID-19 stroke (Caporalea et al, 2017; Fajri et al., 2022)

The data analysis technique uses using multiple regression model. To test the hypothesis in this study is as follows:

$$ROA = \alpha + \beta 1DCovid + \beta 2CAR + \beta 3FDR + \beta 4NPF + \beta 5OCOI + \beta 6SIZE$$

Notes:

ROA : Return on Assets
DCOVID : Dummy COVID-19 (1 for 2020 and 2021 and 0 for the other years)
CAR : Capital Adequacy Ratio
FDR : Financing to Deposit Ratio
NPF : Non-Performing Financing Ratio
OCOI : Operating Costs to Operating Income Ratio
SIZE : Logarithm of total assets

RESULTS AND DISCUSSION

Table 1
Variable Difference Test Results Before and During Covid-19

Ratios	p-Value (2 tailed)
ROA	
Before Covid-19	0.992ns
During Covid-19	
CAR	
Before Covid-19	0.839ns
During Covid-19	
FDR	
Before Covid-19	0.000 ***
During Covid-19	
NPF	
Before Covid-19	0.787ns
During Covid-19	
OCOI	
Before Covid-19	0.510ns
During Covid-19	
SIZE	
Before Covid-19	0.089 *
During Covid-19	

** and *** significant at the 10% and 1% level or ns (not significant), p-value in parentheses*

Based on the result above, FDR and SIZE between before COVID-19 and during COVID-19 had different values. The difference in FDR showed that financing during COVID-19 had been decreased caused by declining economic condition affecting people's low economic activities. The difference in SIZE showed that there were higher savings in IRB before COVID-19 compared to one during COVID-19. It was occurred as an impact of high savings withdrawal to fulfil basic needs caused by decline in people's income. This condition affects IRB's asset decrease during COVID-19 caused by the decrease of third party's fund.

The results of data processing in this study showed that there was no multicollinearity in the regression model because the correlation between the independent variables was smaller than 0.8 (<0.8). There is no regression model from the heteroscedasticity of the Glejser test because the independent variable is not significant to the absolute residual (prob > 0.05). The results also showed no autocorrelation (Durbin Watson value is 2.365).

Table 2
Multiple Regression Result

Variable	Commont Effect Model		Random Effect Model		Fixed Effect Model	
	Coef.	**p-value**	**Coef.**	**p-value**	**Coef.**	**p-value**
Constant	-7.053	0.287	-7.053	0.287	-7.053	0.846
DCOVID	-0.149	0.875	-0.149	0.875	-0.149	0.870
CAR	0.011	0.594	0.011	0.594	0.011	0.627
FDR	-0.008	0.380	-0.008	0.380	-0.008	0.245
NPF	-0.086	0.150	-0.086	0.149	-0.086	0.507
OCOI	-0.014	**80.006	-0.014	0.006***	-0.014	0.158
SIZE	0.632	*0.076	0.632	0.077*	0.632	0.540
R-squared	0.060		0.060		0.339	
Adjusted R-squared	0.041		0.041		0.098	
Prob > F	0.006		0.006		0.029	
Total of observation	296		296		296	

The coefficient of DCOVID pandemic is not significant. This result does not support Almonifi et al. (2021) who discovered negatively minimum impact of COVID-19 on Islamic Banks in Saudi Arabia. Such a low impact is caused by the nature of Islamic Bank which is based on an interest-free system and avoiding toxic assets that hugely influence the performance of mainstream Banks in the middle of crisis Hassan et al., (2020). The existence of Profit and Loss Sharing (PLS) system in the Islamic Bank also minimizes the effect suffered by the Islamic Bank since return for investors is determined by the profit gained (Chapra, 2011). COVID-19 had no impact on IRB performance due to the segmentation of IRB consumers, mostly rural communities who generate income from agriculture, plantations, and trade. These efforts did not have an impact on reducing the income of IRB consumers during the COVID-19 period. Thus, COVID-19 will not have an impact on the financing that has been distributed by the IRB.

CAR has no effect on ROA. The results of this study are in line with the research of Rifai & Suyono, (2019), Azizah & Manda, (2021), Wahyudi, (2020), and (Gunawan et al., 2020). There is no effect of CAR on profitability because banks are very careful in investing their funds so that the CAR value is in accordance with the provisions, so that banks minimize the distribution of funds from their capital. Moreover, with the existence of Bank Indonesia regulations that require a minimum CAR value of 8%. The size of the capital does not determine the size of the profit generated, if the bank is careful in distributing its funds, then CAR will not affect profitability even though the bank has capital and a high CAR ratio.

FDR has no effect on ROA. The higher the FDR does not become a benchmark for banks to obtain high profitability. This shows that the function of the IRB to channel financing has not been carried out properly from all the IRB studied. This research is in line with the research of Rahmawati et al., (2021), (Gunawan et al., 2020), Rifai & Suyono, (2019) and Astuti (2022).

NPF has no effect on ROA. This is possible because the non-performing financing of Islamic banks in Indonesia during the study period was not so large in nominal value. This is also made possible by the bank's prudence in channeling funds to the public amid the current pandemic. This research is in line with the research of Karim & Hanafia, (2020), Gunawan et al., (2020) and Gusmawanti et al., 2020).

OCOI has a negative effect on ROA. Any increase in operating costs that is not followed by operating income will result in reduced profit before tax and will result in ROA. The operational cost ratio is used to measure the level of efficiency and ability of a bank to carry out its operational activities. The smaller this ratio, the more efficient the operational costs incurred by the bank so that the possibility of a bank in a troubled condition also becomes smaller. The greater the OCOI, the smaller the bank's ROA, because the profit earned by the bank is also small. This shows that the increase in the bank's OCOI ratio indicates an increase in the proportion of operating expenses to operating income received by the bank, thus if operating costs increase it will reduce profit before tax which will ultimately reduce ROA at the bank concerned, by thus the greater the OCOI, the smaller the bank's ROA, because the profit earned by the bank is also small. This reflects the presence or occurrence of inefficiencies in operational performance at Islamic commercial banks. The results of this study are in line with the research of Azizah & Manda, (2021), Yuliana and Listari (2021), Hasibuan et al (2021) and Astuti (2022).

SIZE has a positive effect on ROA. A bigger bank has a better performance. A big bank has low fees because there are economies of scale. In addition, a big bank can diversify its income source by taking advantage of various types of investment opportunities. For example, a large bank can take on a riskier project or provide a larger loan to a company. The result of this study is in line with research conducted by Abduh and Issa (2018), Watuseke et.al (2019), Sanusi and Zulaikha (2019), Rahman et.al (2020), Dan and Anh (2020) and Fithriyanto (2021). However, it is different from the research result by Supiyadi and Nugraha (2018) and Farooq et.al. (2021).

CONCLUSION AND SUGGESTION

The results of data processing showed that COVID-19 will not have an impact on the financing distributed by the IRB. OCOI and SIZE variables both affect financial performance. However, CAR, FDR and NPF have no effect on the financial performance of Islamic Rural Banks. COVID-19 did not have any impact on IRB performance due to the segmentation of IRB consumers, mostly rural communities who generate income from agriculture, plantations, and trade. These efforts did not have an impact on reducing the income of IRB consumers during the COVID-19 period. Meanwhile, OCOI has a negative effect on ROA, hence any increase in operating costs that is not followed by operating income will result in reduced profit before tax and will be displayed in ROA. The operational cost ratio is used to measure the level of efficiency and ability of a bank to carry out its operational activities. The smaller the ratio, the more efficient operational costs incurred by the bank, hence smaller possibility of a bank in a troubled condition. SIZE has a positive effect on ROA showing that bigger bank has a better performance caused by economies of scale as an effect of low fees.

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