Factors Influencing the Financial Performance of Islamic Rural Banks in Indonesia

Dedek Sri Wahyuni[1], Hamdi Agustin[2], Rahmat Setiawan[3] and Hasby[4]
[1]*Master of Management Program student, Islamic University of Riau, Indonesia*
[2]*Magister Management Program, Islamic University of Riau, Pekanbaru, Indonesia*
[3]*Faculty of Economic and Business, Islamic University of Riau, Pekanbaru, Indonesia*
[4]*Faculty of Economic and Business Student, Islamic University of Riau, Pekanbaru, Indonesia*

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Abstract: The purpose of this research is to determine the factors that influence the performance of Islamic rural banks in Indonesia. The aim of this research is to identify the factors that impact the performance of Islamic rural banks in Indonesia. It is known that banks in developing countries are more vulnerable to external and massive threats. Therefore, it is very important to study their performance in the era before and during COVID-19. In this study, there were 163 companies in the population of BPRS. Because the data was incomplete and not available on the company's website, the sample could not be taken from all populations. There are 74 datasets that meet the criteria for sampling because they have the most complete financial reports and have been published during the 2018-2021 period. The results of the study show that the dummy variable COVID-19 has no effect on the financial performance of Sharia Rural Banks. Covid-19 has not had an impact on BPRS performance due to the segmentation of BPRS consumers, mostly rural communities who earn income from agriculture, plantations, and trade. The income of BPRS consumers during the Covid-19 period was not affected by these efforts. Thus, Covid-19 will not have an impact on the financing that has been distributed by the BPRS. OCOI and SIZE variables affect financial performance. Meanwhile, the CAR, FDR, and NPF variables have no impact on the financial performance of Sharia Rural Banks.

1 INTRODUCTION

The consequences of COVID-19 for the banking industry in developing countries could result in major problems due to COVID-19 there will be a large increase in the number of people who default on loans, withdrawals will be difficult, clients will withdraw funds in savings to finance basic needs, the amount of funds loan reserves will decrease, and demand for new investment will also decrease (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 know-how. and the novelty does an inadequate part (Barua, 2020). In addition, banks are very important in developing and developing countries to stimulate economic growth. If a bank is in a high-risk condition, then the process of utilizing existing funds in the bank will be significantly hampered (Naqvi et al., 2021; Umar et al., 2021a). As a result, in a country there will be economic development in developing countries will suffer (Xie, et al., 2022).

Various literature highlighting the potential implications of COVID-19 for banks has 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

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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).

The following aspects are influenced by this study's contribution to the literature. 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). The impact of COVID-19 on bank performance is not widely known (Xiazi and Shabir, 2022).

Understanding the financial performance of all Sharia Rural Banks or Sharia People's Financing Banks (BPRS) in Indonesia is absolutely necessary (Wasiaturrahma et al., 2020). This is because several previous studies have separately analyzed BPR and BPRS, such as Muhari and Hosen (2014) and Hartono et al. (2008) and Septianto and Widiharih (2010). Researchers who examined the impact of convid -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). The performance analysis of Sharia Rural Banks in Indonesia has been limited by research specializing in it.

To our knowledge, there is not enough empirical evidence to support the impact of the pandemic on the banking sector's performance. The impact of the Covid-19 pandemic on the performance of the banking sector has not been examined by any empirical study to date. 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 Sharia Rural Banks in Indonesia, so this research needs to be done. Therefore, this study contributes to analyzing 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 on Sharia Rural Banks' financial performance in Indonesia. This study is an attempt to explore the implications of the COVID-19 pandemic for the banking industry in Indonesia. External and massive threats are more likely to affect banks in developing countries, as we already know. Therefore, it is very important to study their performance in the era before and during COVID-19, especially in Sharia Rural Banks in Indonesia. The findings in this study offer valuable implications for banking sector regulation in Indonesia.

2 LITERATURE REVIEW

BPRS is one of the Islamic banking financial institutions, whose operational pattern follows sharia principles or Islamic muamalah. BPRS 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 BPRS 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 an Islamic People's Credit Bank (BPRS), it was also called At-Tamwil as-Sya'bi Alislami, 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 people's credit banks as sharia people's financing 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).

Basically, BPRS are banks that carry out business activities based on Sharia principles, but their activities do not provide payment traffic services as in commercial banks. Intermediation is carried out by raising funds from parties who have excess funds to those who need funds.

BPRS, as Islamic financial institutions, can provide financial services similar to those offered by 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 banking services because they prefer to follow Sharia rules. Second, the Islamic banking system can be implemented as an alternative to restructuring programs with the help of the Indonesian government's initiative.

Islamic People's Financing Bank (BPRS) is 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). Profit-sharing banking system or Islamic banking system is widely known.

The COVID-19 pandemic has caused income from disbursing financing to decrease. COVID-19 has a drawback in that income is lost due to lack of sales, but expenses must still be made. In Indonesia, the spread of the Coronavirus has weakened the performance and capacity of Islamic banks, especially for debtors. The weak performance of debtors can increase the risk of financing, which could 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 BPRS.

3 RESEARCH METHODOLOGY

This study is focused on a BPRS company that has been registered with the Financial Services Authority (OJS) and has financial data from 2018-2021. The sampling method is based on a purposive sampling method based on a technique based on certain criteria. The population of BPRS in this study was 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

4 RESULT AND DISCUSSION

Table 1: 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	

This study revealed no multicollinearity in the regression model because the correlation between the independent variables was less than 0.8 (<unk>0.8). There is no regression model for the heteroscedasticity of the Glejser test because the independent variable is not significant to the absolute residual (prob > 0.05). The results of data processing also show that there is no autocorrelation because the Durbin Watson value is 2,365 which is between 1 and 3.

The coefficient of DCOVID pandemic is not significant. This result does not support Almonifi et al. The 2021 researcher discovered that COVID-19 had a negative impact 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 as the return for investors is determined by the profit gained (Chapra, 2011). Covid-19 has not had an impact on BPRS performance due to the segmentation of BPRS consumers, mostly rural communities who earn income from agriculture, plantations, and trade. These efforts did not have an impact on reducing the income of BPRS consumers during the Covid-19 period. Thus, Covid-19 will not have an impact on the financing that has been distributed by the BPRS.

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. Furthermore, Bank Indonesia's regulations 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, the less likely banks are to achieve high profitability. This shows that the function of the BPRS to channel financing has not been properly carried out in all the BPRS 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 prudent channeling of funds to the public during 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 an increase in operating income will result in reduced profit before tax and a decrease 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 is, the more efficient the operational costs incurred by the bank, so that the possibility of the bank being in troubled condition is also reduced. 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. The presence or occurrence of inefficiencies in operational performance at Islamic commercial banks is reflected by this. 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 large 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) but it is different from the result of research by Supiyadi and Nugraha (2018) and Farooq et.al. (2021).

5 CONCLUSION

The results of data processing show that Covid-19 will not have an impact on the financing that has been distributed by the BPRS. OCOI and SIZE variables affect financial performance. Meanwhile, the CAR, FDR and NPF variables have no effect on the financial performance of Sharia Rural Banks. Covid-19 has not had an impact on BPRS performance due to the segmentation of BPRS consumers, mostly rural communities who have income from agriculture, plantations and trade. The income of BPRS consumers during the Covid-19 period was not affected by these efforts. OCOI has a negative effect on ROA show that 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. SIZE has a positive effect on ROA show that a bigger bank has a better performance. A big bank has low fees because there are economies of scale

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