Islamic Rural Bank Profitability : Evidence from Indonesia

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Abstract

Islamic Rural Bank in Indonesia has experienced an increase of total asset and total financing but showed a decrease of profitability. Analysis of profitability determinants will contribute in increasing Indonesian Islamic Rural Bank profitability. This research aims to analyze Islamic Rural Bank profitability determinants in the short and long run. It applies dynamic model of Error Correction Model (ECM) to find several internal and external factors that influence Islamic Rural Bank profitability in the short and long run. The results of this research can show variables that have a positive and negative effect in the short and long run. Mudharabah Time Deposit becomes dominant variable in affecting Islamic Rural Bank profitability in the short run and has negative effect. Non Performing Financing becomes the dominant variable in the long run and also has negative effect. The dominant variables in the short and long run both have negative effects. It can show why Islamic Rural Bank has experienced a decrease in profitability.

Keywords : Islamic Rural Bank, profitability, Error Correction Model

1. Introduction

Islamic Rural Bank aimed to serve Micro and Small Enterprises that need fast, easy, and simple approval process. Because of its role in giving services to Micro and Small Enterprises, Islamic Rural Bank has an important role in improving financial inclusion.

Islamic Rural Bank in Indonesia has experienced rapid growth. In 2005, total net assets reached 585 billion rupiah, and increased to 3.5 trillion rupiah in 2011. It also has disbursed 417 billion rupiah total financing in 2005 and became 2.7 trillion rupiah in 2011.

Although the amount of asset and financing has increased, according to Islamic Banking Statistic published by Indonesian Central Bank, profitability of Islamic Rural Bank demonstrated by Return on Assets (ROA) showed a decrease.

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Profitability of Islamic Rural Bank reached 4.05% in 2005, and became 2.67% in 2011. In 2012, the profitability decreased again to 2.64%.

Meanwhile, according to World Bank Global Financial Inclusion Index 2012, access to financial services in Indonesia is still very low. Only 20% of Indonesian people aged over 15 years have used financial services. This figure is far lower than China and India, each of which has reached 64% and 35% respectively.

Profitability of Islamic Rural Bank should be improved to continue its development. Better performance of Islamic Rural Bank will further improve financial inclusion in Indonesia. In the long run, Islamic financial development will contribute in Indonesian economic growth (Yazdan and Sadr, 2012). Analysis of profitability determinants is needed to give contribution in finding variables that have significant influences on Islamic Rural Bank profitability.

Meanwhile, research on Islamic Rural Bank profitability is still rare. Most researches are about conventional microfinance and microbank. Some previous researches about conventional microfinance and microbank are as follows. Muriu (2011) has done research on profitability determinants of microfinance in Africa using panel data model. Imai, Gaiha, Thapa, Annim, and Gupta (2011) have done research about cross-country microfinance profitability determinants using three stage least squares (3SLS) and fixed effect vector decomposition (FEVD). Muhammad, Waweru, and Porporato (2011), have measured the sustainability of microfinance in Bangladesh using Return on Assets (ROA) as the proxy of sustainability. Ghani and Mahmoud (2011) studied about determinants of microfinance performance in Pakistan, and Dissanayake (2012) about Sri Lankan microfinance.

Analysis of Islamic Rural Bank profitability determinants is needed to increase the profitability of Islamic Rural Bank in Indonesia. It can indicate which variables that significantly influence Islamic Rural Bank profitability and whether these variables have positive or negative effects. It will further give solutions for increasing Islamic Rural Bank profitability.

Differences of this research over previous researches are as follows. First, this research uses data of Islamic Rural Bank in Indonesia. Second, this research uses internal and external factors as Islamic Rural Bank profitability determinants. Third, this research uses some specific variables of Islamic bank such as Equity Financing (Mudharabah and Musharakah Financing), Mark Up Financing (Murabahah Financing), Mudharabah Saving Deposit, and Mudharabah Time Deposit. Fourth, this research uses dynamic model of Domowitz-El Badawi Error Correction Model (ECM) for analysing Islamic Rural Bank profitability determinants in the short and long run. ECM is a dynamic model for correcting short run time series data disequilibrium into long run equilibrium. Because of its advantages in combining short and long run effects, ECM becomes a model that can explain the explanatory variables well.
2. Research Method

This research uses data from monthly Islamic Rural Bank Statistic published by Central Bank of Indonesia for the period of January 2007 – March 2012. The data consist of Islamic Rural Banks profitability and its determinants. This research uses variables as follows.

**Table 1. Variable Description**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Symbol</th>
<th>Variable Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dependent</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profitability</td>
<td>ROA</td>
<td>Net Income / Total Assets</td>
</tr>
<tr>
<td>Independent</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Financing</td>
<td>TOF</td>
<td>Total Financing / Total Assets</td>
</tr>
<tr>
<td>Mark Up Financing</td>
<td>MUF</td>
<td>Murabahah Financing / Total Assets</td>
</tr>
<tr>
<td>Equity Financing</td>
<td>EQF</td>
<td>Mudharabah and Musyarakah Financing / Total Assets</td>
</tr>
<tr>
<td>Non Performing Financing</td>
<td>NPF</td>
<td>Non Performing Financing / Total Financing</td>
</tr>
<tr>
<td>Total Depositor Funds</td>
<td>TDF</td>
<td>Total Depositor Funds / Total Assets</td>
</tr>
<tr>
<td>Mudharabah Time Deposit</td>
<td>MTD</td>
<td>Mudharabah Time Deposit / Total Assets</td>
</tr>
<tr>
<td>Mudharabah Saving Deposit</td>
<td>MSD</td>
<td>Mudharabah Saving Deposit / Total Assets</td>
</tr>
<tr>
<td>Bank Size</td>
<td>SZE</td>
<td>Growth of Total Assets</td>
</tr>
<tr>
<td>Inflation</td>
<td>INF</td>
<td>Rate of Inflation</td>
</tr>
<tr>
<td>Money Supply</td>
<td>M2</td>
<td>Growth of Money Supply</td>
</tr>
</tbody>
</table>

This research uses dynamic model of Domowitz-El Badawi ECM. Steps to analyse Islamic Rural Bank profitability determinants for short and long run using ECM are Classical Assumption Test, Stationary Test, Cointegration Test, and then Error Correction Model.
Error Correction Model (ECM) is a technique or model for correcting short run disequilibrium into long run equilibrium. Because of its advantages in combining short and long run effects, ECM becomes a model that can explain the explanatory variables well. ECM equation of this research is as follows:

\[ DY_t = b_0 + b_1 DX_{1t} + b_2 DX_{2t} + b_3 DX_{3t} + b_4 DX_{4t} + b_5 DX_{5t} + b_6 DX_{6t} + b_7 DX_{7t} + b_8 DX_{8t} + b_9 DX_{9t} + b_{10} DX_{10t} + b_{11} ECT_{t-1} + e_t \]

where:

- Y = Return On Asset (ROA)
- X_1 = Total Financing (TOF)
- X_2 = Mark Up Financing (MUF)
- X_3 = Equity Financing (EQF)
- X_4 = Non Performing Financing (NPF)
- X_5 = Total Depositor Funds (TDF)
- X_6 = Mudharabah Time Deposit (MTD)
- X_7 = Mudharabah Saving Deposit (MSD)
- X_8 = Bank Size (SZE)
- X_9 = Inflation (INF)
- X_{10} = Money Supply (M2)
- ECT = Error Correction Term
- e = error term

\[ ECT_{t-1} = Y_{t-1} - b_0 - b_1 X_{1t-1} - b_2 X_{2t-1} - b_3 X_{3t-1} - b_4 X_{4t-1} - b_5 X_{5t-1} - b_6 X_{6t-1} - b_7 X_{7t-1} - b_8 X_{8t-1} - b_9 X_{9t-1} - b_{10} X_{10t-1} \]

ECM will have valid model specification if it has a statistically significant Error Correction Term (ECT) coefficient. Probability value of ECT coefficient that is less than 5% significance level will indicate its significance.

3. Result and Discussion

Classical assumption test results indicate that this research model is free from autocorrelation, multicollinearity, and heteroscedasticity problems. It also meets the assumption of normality.
Augmented Dickey Fuller (ADF) stationary test results indicate that all variables are stationary at first difference stage, while Johansen cointegration test results indicate that all independent variables are cointegrated with dependent variable in the long run. This results mean that the research can be continued to ECM.

3.1. Error Correction Model Result

Error Correction Model (ECM) test result is as follows:

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>0.310485</td>
<td>0.089278</td>
<td>3.477734</td>
<td>0.0012</td>
</tr>
<tr>
<td>D(MTD)</td>
<td>-0.557688</td>
<td>0.183057</td>
<td>-3.046529***</td>
<td>0.0041</td>
</tr>
<tr>
<td>D(EQF)</td>
<td>0.273700</td>
<td>0.129630</td>
<td>2.111403**</td>
<td>0.0410</td>
</tr>
<tr>
<td>D(INF)</td>
<td>0.065903</td>
<td>0.088218</td>
<td>0.747053</td>
<td>0.4594</td>
</tr>
<tr>
<td>D(M2)</td>
<td>0.163357</td>
<td>0.029741</td>
<td>5.492571***</td>
<td>0.0000</td>
</tr>
<tr>
<td>D(MUF)</td>
<td>-0.027845</td>
<td>0.074869</td>
<td>-0.371913</td>
<td>0.7119</td>
</tr>
<tr>
<td>D(NPF)</td>
<td>-0.513143</td>
<td>0.156421</td>
<td>-3.280532***</td>
<td>0.0022</td>
</tr>
<tr>
<td>D(SZE)</td>
<td>0.015348</td>
<td>0.010212</td>
<td>1.502945</td>
<td>0.1407</td>
</tr>
<tr>
<td>D(MSD)</td>
<td>0.015060</td>
<td>0.127362</td>
<td>0.118246</td>
<td>0.9065</td>
</tr>
<tr>
<td>D(TDF)</td>
<td>0.010405</td>
<td>0.080120</td>
<td>0.129869</td>
<td>0.8973</td>
</tr>
<tr>
<td>D(TOF)</td>
<td>0.048424</td>
<td>0.065254</td>
<td>0.742082</td>
<td>0.4624</td>
</tr>
<tr>
<td>MTD(-1)</td>
<td>-0.552420</td>
<td>0.189980</td>
<td>-2.907776***</td>
<td>0.0059</td>
</tr>
<tr>
<td>EQF(-1)</td>
<td>-0.321708</td>
<td>0.118816</td>
<td>-2.707624***</td>
<td>0.0099</td>
</tr>
<tr>
<td>INF(-1)</td>
<td>-0.521264</td>
<td>0.144257</td>
<td>-3.613449***</td>
<td>0.0008</td>
</tr>
<tr>
<td>M2(-1)</td>
<td>-0.261347</td>
<td>0.125543</td>
<td>-2.081738**</td>
<td>0.0438</td>
</tr>
<tr>
<td>MUF(-1)</td>
<td>-0.536626</td>
<td>0.128637</td>
<td>-4.171625***</td>
<td>0.0002</td>
</tr>
<tr>
<td>NPF(-1)</td>
<td>-1.080857</td>
<td>0.223261</td>
<td>-4.841216***</td>
<td>0.0000</td>
</tr>
<tr>
<td>SZE(-1)</td>
<td>-0.458967</td>
<td>0.134572</td>
<td>-3.410566***</td>
<td>0.0015</td>
</tr>
<tr>
<td>MSD(-1)</td>
<td>-0.220082</td>
<td>0.149943</td>
<td>-1.467772</td>
<td>0.1500</td>
</tr>
<tr>
<td>TDF(-1)</td>
<td>-0.592973</td>
<td>0.173500</td>
<td>-3.417716***</td>
<td>0.0015</td>
</tr>
<tr>
<td>TOF(-1)</td>
<td>-0.514662</td>
<td>0.117312</td>
<td>-4.387106***</td>
<td>0.0001</td>
</tr>
<tr>
<td>ECT</td>
<td>0.426972</td>
<td>0.128381</td>
<td>3.325818***</td>
<td>0.0019</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.828260</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted R-squared</td>
<td>0.738096</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F-statistic</td>
<td>9.186172</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prob (F-statistic)</td>
<td>0.000000***</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
** and *** indicate significance level of 5 and 1 percent respectively.

ECM has a valid model specification because it has statistically significant Error Correction Term (ECT) coefficient. Other analyses from Table 2 above are as follows.

Table 2 above shows that Adjusted R-squared value is 0.738096 which endorses that 73.8% of the variation in the dependent variable can be explained by the independent variables of the model. While the 26.2% variation in the dependent variable remains unexplained by the independent variables. F statistic value is 9.186 with 0.000 probability value. It indicates that all independent variables have significant influence on dependent variable simultaneously.

Analysis of independent variables influence on Islamic Rural Bank profitability in the short and long run uses ECM T Statistic Test results in Table 2. Based on short run analysis of T Statistic Test, short run ECM equation is as follows:

$$\text{ROA} = 0.310 - 0.558\text{MTD} + 0.274\text{EQF} + 0.163\text{M2} - 0.513\text{NPF}$$

Based on long run analysis of T Statistic Test, long run ECM equation is as follows:

$$\text{ROA} = 0.727 - 0.294\text{MTD} + 0.247\text{EQF} - 0.221\text{INF} + 0.388\text{M2} - 0.257\text{MUF} - 1.531\text{NPF} - 0.075\text{SZE} - 0.389\text{TDF} - 0.205\text{TOF}$$

Analyses of ECM short and long run equations give some indications about the influence of independent variables on dependent variable in the short and long run as follows.

### 3.1.1. Total Financing

Total Financing (TOF) has no significant effect on Islamic Rural Bank profitability in the short run but has a significant negative effect at 1% significance level in the long run. This result means that Total Financing has a great negative influence on Islamic Rural Bank profitability in the long run. Increasing the percentage of total financing to total assets will further decrease Islamic Rural Bank profitability.

Negative and significant influence of Total Financing is not in accordance with previous study by Khrawish (2011) which indicates that Total Loan to Total Assets variable has positive effect on commercial banks profitability in Jordan. It is also inconsistent with previous research by Ramadan, Kilani, and Kaddumi (2011) which shows that total loan to total asset variable has positive influence on bank profitability in Jordan. Financings are productive assets that should generate returns for banks.
But the negative and significant effect of Total Financing is in accordance with the research by Alper and Albar (2011) that loan to asset variable has negative effect on commercial bank Return on Asset in Turkey. It is also consistent with previous research by Davydenko (2010) on banks profitability in Ukraine. According to Davydenko (2010), negative effect of total loans may indicate poor quality of bank loans.

Negative effect of Total Financing on Islamic Rural Bank profitability in Indonesia can be caused by poor quality of the financing. Based on Islamic Banking Statistics published by Central Bank of Indonesia, Non Performing Financing (NPF) of Islamic Rural Bank until March 2012 is about 6-8%. This NPF is higher than Islamic Commercial Bank and Islamic Business Unit NPF that is about 2-4% until March 2012. This result means that Islamic Rural Bank should improve the quality of financing in order to improve profitability.

3.1.2. Mark Up Financing

Mark Up Financing (MUF) has no effect on Islamic Rural Bank profitability in the short run but has a significant negative effect at 1% significance level in the long run. This result means that in the long run, the increase of Mark Up Financing (murabahah financing) will further decrease profitability.

Significant negative effect of Mark Up Financing in the long run is consistent with significant negative effect of Total Financing variable above. This result suggests that significant negative effect of Total Financing on Islamic Rural Bank profitability in the long run above can be derived from the significant negative effect of Mark Up Financing. This can be because most of financings in Islamic Rural Bank are in the form of Mark Up Financing. According to Islamic Banking Statistics published by Central Bank of Indonesia, the average percentage of Mark Up Financing to total assets is large enough which is 79.6%.

3.1.3. Equity Financing

Equity Financing (EQF) has a significant positive influence on Islamic Rural Bank profitability at 5% significance level in the short run and 1% significance level in the long run. This result shows a greater positive effect of Equity Financing in the long run than short run. Increasing the percentage of mudharabah and musharakah financing to total assets will increase Islamic Rural Bank profitability.

Positive influence of Equity Financing is not in accordance with the negative effect of Total Financing variable above. This difference can be due to smaller percentage
of Equity Financing to total assets than the percentage of Mark Up Financing to total assets. Average percentage of Equity Financing to total assets is only 13.2%, while average percentage of Mark Up Financing is 79.6%. Equity Financing has a positive effect, whereas Mark Up Financing has a negative effect on Islamic Rural Bank profitability. This result shows that Islamic Rural Bank should increase the amount of Equity Financing (mudharabah and mushararakah financing) rather than Mark Up Financing (murabahah financing) for increasing profitability.

3.1.4. Non Performing Financing

Non Performing Financing (NPF) has significant negative impact on Islamic Rural Bank profitability at 1% significance level in the short and long run. This result means that Non Performing Financing has a great negative influence on Islamic Rural Bank profitability. The greater the percentage of Non Performing Financing will further decrease profitability.

Negative influence of NPF is consistent with previous study by Akhtar, Ali, and Sadaqat (2011) that Non Performing Financing has negative effect on Islamic bank profitability in Pakistan. It is also in accordance with previous research by Olweny and Shipo (2011) on commercial banks profitability in Kenya. Previous research by Choong, Thim, and Kizy (2012) also shows that credit risk has negative influence on ROA of Islamic Commercial Banks in Malaysia. High ratio of non performing financing indicates poor asset quality. Islamic Rural Banks need to improve their processes of screening financing applicants and monitoring credit risk for the purpose of increasing profitability.

3.1.5. Total Depositor Fund

Total Depositor Fund (TDF) has no significant effect on Islamic Rural Bank profitability in the short run but has significant negative effect at 1% significance level in the long run. This result suggests that Total Depositor Fund has a great negative influence on Islamic Rural Bank profitability in the long run. Increasing the percentage of Total Depositor Fund to total asset will further reduce profitability.

Negative influence of Total Depositor Fund is not in accordance with previous research by Hien (2009) which indicated that total deposits divided by total assets variable has positive effect on microfinance profitability in Southeast Asia. It is also inconsistent with previous study by Gul, Irshad, and Zaman (2011) that shows positive effect of deposits to total assets variable on bank profitability in Pakistan. Greater depositor funds should increase profitability because bank can disburse more financings that generate more returns.
But the negative effect of Total Depositor Fund is consistent with the results of previous study by Davydenko (2010) on bank profitability in Ukraine. According to Davydenko (2010), negative effect of total deposits may indicate that intense competition faced by banks has made it difficult for them to lower the rate of return that must be provided for depositors.

Based on Islamic Banking Statistics published by Central Bank of Indonesia, percentage of time deposits to total depositor funds until March 2012 is 60% and percentage of saving deposits to total depositor funds is 40%. It means that most of Islamic Rural Bank depositor funds are in the form of time deposits that are more expensive sources of funds than saving deposits.

Whereas, percentage of murabahah financings to total financings is 81% and percentage of mudharabah and musharakah financings to total financings is only 11%. It means that most of financing provided by Islamic Rural Bank is in the form of murabahah financing that provides smaller equivalent rate of return than Equity Financing (mudharabah dan musharakah financing). This has lead to a greater number of depositor funds followed by a decrease in Islamic Rural Bank profitability.

This result shows that most of depositor funds in Islamic Rural Bank are expensive source of funds but most of the financings are murabahah financings that give lower return than equity financings. It means that Islamic Rural Bank should increase the cheaper sources of funds that is saving deposit rather than time deposit for increasing profitability.

3.1.6. Mudharabah Time Deposit

Mudharabah Time Deposit (MTD) has significant negative impact on Islamic Rural Bank profitability at 1% significance level in the short and long run. This result shows that Mudharabah Time Deposit has a great negative influence on Islamic Rural Bank profitability. Increasing the percentage of Mudharabah Time Deposit to total assets will further decrease profitability.

Significant negative effect of Mudharabah Time Deposit is in accordance with significant negative effect of Total Depositor Fund variable above. This result suggests that significant negative effect of Total Depositor Fund on Islamic Rural Bank profitability above can be derived from the significant negative effect of Mudharabah Time Deposit.

Based on Islamic Banking Statistics published by Central Bank of Indonesia, until March 2012, percentage of Mudharabah Time Deposit to Total Depositor Fund is 60%, and percentage of Mudharabah Saving Deposit to Total Depositor Fund is only 21%. It shows that most depositor funds of Islamic Rural Bank are in the form of
Mudharabah Time Deposit. It leads to the negative influence of Mudharabah Time Deposit in accordance with the negative influence of Total Depositor Funds.

3.1.7. Mudharabah Saving Deposit

Mudharabah Saving Deposit (MSD) has no significant effect on Islamic Rural Bank profitability in the short and long run. This result is not in accordance with the significant negative influence of Total Depositor Fund variable above. This can be caused by the small percentage of Mudharabah Saving Deposit to Total Depositor Fund that is only 21%.

3.1.8. Inflation

Inflation (INF) has no significant effect on Islamic Rural Bank profitability in the short run but has significant negative effect at 1% significance level in the long run. This result suggests that inflation rate has a great negative impact on Islamic Rural Bank profitability in the long run. Higher inflation rate will lead to lower profitability.

This negative effect of inflation is inconsistent with previous study by Smaoui and Salah (2012) that inflation rate has positive influence on Return on Asset of Islamic bank in GCC region. It is also not in accordance with previous research by Gul, Irshad, and Zaman (2011) that shows positive effect of inflation rate variable on bank profitability in Pakistan.

According to Smaoui and Salah (2012), the impact of inflation on profitability could be positive or negative depending on whether it is anticipated or unanticipated. In the case of anticipated inflation, it is expected to give positive impact on profitability since banks can timely adjust interest rates or equivalent rate of return, resulting in revenues increasing faster than costs. In the case of unanticipated inflation, it is expected to give negative impact on profitability since banks may be forced to adjust slowly their interest rates or equivalent rate of return, leading to a faster increase of bank costs than banks revenues.

But this negative effect of inflation is consistent with the research by Ali, Akhtar, and Ahmed (2011) that inflation rate has negative effect on profitability of commercial banks in Pakistan. It is also in accordance with previous research by Zeytun (2012) on Islamic and conventional banks profitability in GCC countries. The result of this research shows that the change in inflation rate can not be anticipated by Islamic Rural Bank in Indonesia.
3.1.9. Money Supply

Money Supply (M2) has positive and significant influence on Islamic Rural Bank profitability at 1% significance level in the short run and 5% significance level in the long run. This result shows stronger positive effect of money supply growth in the short run than long run.

Significant positive influence of Money Supply is consistent with previous research by Srairi (2009) that M2 (money supply growth) variable has positive effect on Islamic banks profitability in GCC countries. It is also in accordance with research by Al-Jarrah, Ziadat, and El-Rimawi (2010) that money supply growth has positive impact on Jordanian’s banks profitability.

3.1.10. Bank Size

Bank Size (SZE) has no significant effect on Islamic Rural Bank profitability in the short run but has significant negative effect at 1% significance level in the long run. This result means that bank size has a great negative influence on Islamic Rural Bank profitability in the long run. The greater the growth of total assets will further decrease profitability.

Significant negative effect of Bank Size is inconsistent with previous research by Idris, Asari, Taufik, Salim, Mustaffa, and Jusoff (2011) that Bank Size variable has significant positive impact on listed Islamic banks profitability in Malaysia. It is also not in accordance with the research by Gul, Irshad, and Zaman (2011) that size variable has positive influence on bank profitability in Pakistan. Greater assets owned by bank should generate more profitability.

But significant negative influence of Bank Size is consistent with previous study by Javaid, Anwar, Zaman, and Gafoor (2011) that bank size variable has negative effect on bank profitability in Pakistan. It is also in accordance with the research by Zeytun (2012) that size variable has negative effect on Islamic bank Return on Assets in GCC countries.

According to Javaid, Anwar, Zaman, and Gafoor (2011), negative effect of bank size on profitability can be caused by diseconomies of scale that is possible bureaucratic bottlenecks and managerial inefficiency. Negative influence of Bank Size on Islamic Rural Bank profitability in Indonesia means that Islamic Rural Bank should improve managerial efficiency for increasing its profitability.
4. Conclusion and Recommendation

4.1. Conclusion

Based on ECM result analysis above, Mudharabah Time Deposit and Non Performing Financing become variables that have negative influence on Islamic Rural Bank profitability in the short run. Whereas, Equity Financing and Money Supply become variables that have a positive effect in the short run.

Mudharabah Time Deposit, Inflation, Mark Up Financing, Non Performing Financing, Bank Size, Total Depositor Funds, and Total Financing become variables that negatively influence Islamic Rural Bank profitability in the long run. Whereas, Equity Financing and Money Supply become variables that have positive effect in the long run.

Equity Financing and Money Supply become variables that have a positive effect on Islamic Rural Bank profitability both in the short and long run. So these two variables are very influential for increasing Islamic Rural Bank profitability.

Mudharabah Time Deposit and Non Performing Financing have a negative effect on Islamic Rural Bank profitability both in the short and long run. So these variables are highly influential in the decrease of Islamic Rural Bank profitability.

Mudharabah Time Deposit becomes dominant variable in affecting Islamic Rural Bank profitability in the short run and has negative effect. But in the long run, Mudharabah Time Deposit no longer becomes the dominant variable. Non Performing Financing becomes the dominant variable in the long run and has negative effect. It means that Non Performing Financing becomes bigger problem in the long run for Islamic Rural Bank. The dominant variables in the short and long run both have negative effects. It can show why the profitability of Islamic Rural Bank has decreased.

4.2. Recommendation

Based on the results of this research, it is useful to draw several recommendations in order to increase Islamic Rural Bank profitability. First, Islamic Rural Bank should improve financing quality by reducing non performing financing because Non Performing Financing variable becomes the dominant variable in the long run and has negative effect. Second, Islamic Rural Bank should increase Equity Financing (Mudharabah and Musharakah Financing) rather than Mark Up Financing (Murabahah Financing) because Equity Financing has positive effect on Islamic Rural Bank profitability and has greater equivalent rate of return than Mark Up
Financing. Third, Islamic Rural Bank should increase cheaper sources of depositor funds such as saving deposits rather than time deposits because saving deposits have lower equivalent rate of return than time deposits, and Mudharabah Time Deposit variable has negative effect on Islamic Rural Bank profitability. Fourth, Islamic Rural Bank should improve managerial efficiency therefore the more assets owned by Islamic Rural Bank, the greater the profitability.

References


