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The Financial Performance of Aqad Shirkah: A case study of financial and non-financial institutions

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Abstract

There is a recognized opportunity to generate profit from the intermediation between savers and investors or lenders and borrowers. This led to the growth of the conventional financial system. In contrast, Islamic institutions that fund business activities must comply with the Shariah. This study investigates the financial performance of the aqad Shirkah (joint venture). The result shows that the financial performance is categorized as very healthy. In contrast, BCA Commercial was unhealthy. It indicates that the Aqad Shirkah is more profitable compared to other financial systems.

Keywords: Aqad Shirkah (Joint Venture); Financial and Non-Financial Institutions; Financial Performance.

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El desempeño financiero de Aqad Shirkah: Un estudio de caso de instituciones financieras y no financieras

Resumen

Existe una oportunidad reconocida para generar ganancias a partir de la intermediación entre ahorradores e inversores o prestamistas y prestatarios. Esto condujo al crecimiento del sistema financiero convencional. En contraste, las instituciones islámicas que financian actividades comerciales deben cumplir con la Shariah. Este estudio investiga el desempeño financiero de la Aqad Shirkah (empresa conjunta). El resultado muestra que el desempeño financiero se clasifica como muy saludable. Por el contrario, BCA Comercial no era saludable. Indica que el Aqad Shirkah es más rentable en comparación con otros sistemas financieros.

Palabras clave: Aqad Shirkah (Joint Venture); Instituciones financieras y no financieras; Rendimiento financiero.

1. INTRODUCTION

For Muslims, Islam is a complete way of life "a mercy to all creation" and regulates the relationship between God (Khaliq) and human beings (Insaanun) (Horrie & Chippindale (2007). Islam also regulates the relationships among human beings includes their business activities under the legal category called Muamalat (Naim, An-Náim & An-Na'im Na, 2008). Verse 275 of surah Al Baqarah revealed "…Allah has permitted trade and has forbidden interest." It means that Allah prohibited riba or usury from business transactions (Hanif, 2014; Hasan & Dridi, 2011 and Saputra, Kusairi & Sanusi, 2017a). In a globalised world, many business institutions are established to generate and maximise profit from investment activities (Iqbal, 1997; Saputra, Kusairi, & Sanusi, 2017b).

This commercial activity is processed through a conventional or Islamic financial system. However, many Muslim operate a Western financial system. This has created space for the establishment of financial and non-financial institutions to offer financial products that comply the Shariah such as Islamic banking, Islamic insurance (Takaful), Islamic investment (Sukuk) and others (Saputra, Kusairi, Sanusi, & Abdullah, 2016). Gumusay (2016) stated that today's financial models lack regulations. Not surprisingly, multiple financial crises have occurred (Ahmed, 2010). This has led Muslim scholars to investigate the financial system applied by Muslim countries which were resilient to the economic crisis in 2008 (Hasan & Dridi 2011). Based on the advantages of Islamic financial system, this study investigates the practice of aqad shirkah (joint venture contract) and its financial performance which has received minimal research.

2. LITERATURE BACKGROUND

Shirkah or Musharakah or sharikah can be defined as a form of partnership between two or more individuals wherein they combine a portion of their capital or labour in order to share the profits and bear losses from business activities while enjoying similar rights and liabilities (Ibn Rushd al-Hafid, 1995; al-Bajuri, 1999; al-Kasani, 2000; Lewis, 2001). In Islamic law, the Hanafi and Hanbali schools divide shirkah into Shirkah al-milk (joint ownership on a non-contractual basis) and shirkah al-uqud (contractual partnership). The Hanafis and Hanbalis further divided the shirkah al-milk into shirkah al-milk iktiyari (voluntary co-ownership) and shirkah al-milk mirath (without partner willingness). However, al-Kasani

(2000) revealed that the Malikis have classified shirkah al-milk into shirkah irth (partnership because of inheritance), shirkah al-ghaniah (partnership among soldiers in assets left) and shirkah al-mubta'in (partnership among purchasers).Hasanuzzaman (1971), Lewis (2001) and Farooq (2007) studies the concept of shirkah. Further, Asmadi Mohamed Naim (2011) discussed the issue of musharakah mutanaqisah (home financing) as practised by Islamic banks in Malaysia. This study found that the shirkat al-milk is a form of home financing but not in its entirety because it does not comply with all the features of shirkat al-milk. Further, scholars disputed concerning allowing a pre-determined price of the bank's portion or share in the house and to stipulate a second promise in the event of default.

Farooq (2007) found that a partnership is the least common form of business organisation for practical reasons to cover equity-financing. Islamic financial institutions (IFIs) are organised as banks, but rather than being financial intermediaries; they are primarily merchant banks. Further, while paying lip service to Profit and Loss Sharing (PLS) modes to define themselves as interest-free aka Islamic entities, IFIs continue to marginalise PLS by packaging conventional banking products under Islamic labels. Further, Dar & Presley (2000) studied the lack of profit loss sharing (PLS) in Islamic banking. They found that without management and control, Islamic banks will persist in taking the easy and risk-averse route and avoid profit and loss sharing (PLS) contracts. Previous studies only focused on financial institutions such as banks with a concern on their practices of profit sharing and loss bearing (PLS). The concept of shirkah in non-financial institutions has not been adequately researched. Thus, in the present paper, we investigate the concept of shirkah as practised by non-financial institutions. We also compare the financial performance of non-financial institutions which apply aqad shirkah through return on asset (ROA) and return on equity (ROE) (Waljinah, 2019).

3. METHODOLOGY

One of the challenges in the development of the Islamic financial system is the lack of measurement tools to assess the financial performance of financial and non-financial institutions. As a result, many researchers have adopted a general measurement tool used by the commercial bank through financial ratios to assess their financial performance. This is applied to assess the Islamic financial performance using the values of ROE and ROA. Therefore, the ratio of net income to assets indicates the firm's net profit generated from capital (money) invested in total assets and can be formulated as below:

$$ROA = \frac{NIC}{ATA} X100\% \tag{1}$$

Where return on asset is denoted by ROA, NIC is earning after tax (net income), and ATA is the average total assets. Furthermore, determining the fitness ratios of the company measured by ROA can be categorised as follows:

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Table 1. The level of business health - ROA criteria

Ratio Interval	Rank	Category
ROA > 1.5%	1	Very Healthy
1.25% < ROA ≤ 1.5%	2	Healthy
0.5% < ROA ≤ 1.25%	3	Fair
0 ≤ ROA ≤ 0.5%	4	Unhealthy
ROA < 0%	5	Very Unhealthy

Source: Bank Indonesia (2007)

Further, the ratio of net income to shareholders' equity represents the profit generated from capital (money) of shareholder's investment (shareholder's equity) and can be determined using the following formula:

$$ROE = \frac{NIC}{EIC} X100\% \qquad (2)$$

Where, return on equity is denoted by ROE, NIC is earning after tax (net income) and EIC is equity income. Further, utilising the measurement tool developed by Bank of Indonesia, the level of business health - ROE criteria can be presented as follows:

Table 2. The level of business health - ROE criteria

Ratio	Rank	Category
ROE > 15%	1	Very Healthy
12,5% < ROE ≤ 15%	2	Healthy
5% < ROE ≤ 12,5%	3	Fair
0 < ROE ≤ 5%	4	Unhealthy
ROE ≤ 0%	5	Very Unhealthy

Source: Bank Indonesia (2007)

4. RESULTS AND DISCUSSION

To achieve the research objective, we use the financial reports of Jroh Production for the year 2016. From Table 3 below, we found that the ratio of profit of Jroh Production in 2016 is 16.38%. Current earnings for one year is IDR 197,066,556.11 and total income is IDR 1,202,856,917.78.

Table 3. Financial Report of Jroh Production

Balance Sheet and Loss/ Profit	
Total income (1 year)	1,202,856,917.78
Initial capital	1,049,312,527.84
Total capital (1 year)	10,580,041,311.53
Capital at the end of the year plus initial capital	11,629,353,839.37
Ratio profit *(profit/income x 100%)*	16,38%
Retained earnings for 1 year	178,240,466.43
Current earnings for 1 year	197,066,556.11
Current earnings at the end of the year plus earning from the initial capital	222,246,200.80

Source: Report of the *Shirkah* Investment of Jroh Poduction (2017)

Table 4. Result of Financial Ratio (ROA and ROE)

Financial Ratios	Percent
Return On Assets (ROA)	1,91%
Return On Equity (ROE)	1,91%

Based on Table 4, we calculate the financial ratios for ROA and ROE. After calculating both ratios, we found that the ROA and ROE of Jroh Production is 1.91%. This categorises the business as very healthy. Meanwhile, ROE is unhealthy. Using the financial report of Bank Central Asia Islamic for 2016 to investigate the advantages of Aqad shirkah and its financial performance, we conclude the following:

Table 5. Financial Report of BCA Islamic

Balance Sheet (in billion - IDR)	
Total assets	1.602,2
Total Earning Assets	1.523,6
Current accounts with Bank Indonesia	58,8
FASBIS	258,0
Conventional Credit – Gross	-
Shariah Financing – Gross	1.077,7
Securities	206,9
Third-party funds	1.261,8
Giro	143,2
Savings	133,0
Deposit	985,5
Loans received	0,1
Equity	304,4
Profit and Loss (in billion - IDR)	
Net profit sharing revenue	64,7
Net interest income	-
Revenue-sharing and net interest	64,7
Other operating income	7,5
Other operating expenses	59,6
Allowance for write-off of other assets	1,5
Operational profit	11,0
Earnings before income tax	11,0

Net profit	8,4
Financial Ratios (Percentage)	
ROA	0.8%
ROE	2.8%
Net Core Operating Margin (NCOM)	9,6%
Capital Adequacy Ratio (CAR)	31,5%
Credit / Financing Ratio to Deposits (LDR / FDR)	79,9%
Ratio of NPL / NPF to total credit / Financing - Gross	0,1%

Source: Bank Indonesia (2017)

Table 6 displays BCA Commercial's financial report in the year 2016 that consists of balance sheets, profit-loss and financial ratios. Similar to the Islamic bank, we found that the value of ROA is 0.23% and ROE is 0.04%. It indicates that the level of business health of BCA is unhealthy. This study also presents real investment returns received by investors (Sahibul mal) under aqad shirkah or joint venture (Al Musharakah).

Table 6. The value of Profit Sharing (PS) received by *Sahibul mal*

Initial Value of Investment	Panel 1	Panel 2	Panel 3
	50,000,000	80,000,000	100,000,000
Lower Bound (π %)	4.29	4.29	4.29
Upper Bound (π %)	37	37	37

Month	Value of profit sharing (in IDR)		
1	872,618.93	1,396,190.28	1,745,237.85
2	433,691.26	693,906.01	867,382.51
3	626,873.32	1,002,939.70	1,253,674.63
4	414,089.55	662,543.27	828,179.09
5	719,544.76	1,151,271.61	1,439,089.51
8	310,458.14	496,733.03	620,916.28
10	451,944.14	723,110.62	903,888.28
11	725,390.09	1,160,624.14	1,450,780.18

12	2,676,300.12	4,282,080.18	5,352,600.23
Total	7,230,874.28	11,569,398.85	14,461,748.57
Average (π %)	14.46	14.46	14.46

Table 7 shows the value of Profit Sharing (PS) received by sahibul mal based on their investment values. We use three panels (e.g. Panel 1, Panel 2 and Panel 3) and each (sahibul mal) is assumed to have invested IDR 50,000,000.-, IDR 80,000,000.-, and IDR 100,000,000 respectively. Using three panels, the ratio of profit for lower bound is 4.29%, upper bound is 37%, and that average is 14.46%. Profit was not obtained for two months because it was the fasting month or business activities were stopped. Thus, we can conclude that increasing the initial value of investment results in increased return received by sahibul mal.

5. CONCLUSION

Among the three institutions sampled in this study, we found that the business health of Jroh Production Company assessed by ROA is health. BCA Islamic is also healthy whole BCA Commerce was unhealthy. Further, utilising ROE, all of the businesses scored less than 0.5% or can be categorised as unhealthy. In others word, through the aqad shirkah (al musharakah), Jroh Production earned higher profit compared to BCA (Islamic and Commerce). It means that the Islamic financial system through aqad shirkah is more effective and efficient for business health and proved its advantages compared to other contracts utilised by Islamic and commercial banks.

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