

# FINANCIAL PERFORMANCE OF ISLAMIC RURAL BANKS AND CONVENTIONAL RURAL BANKS IN MAGETAN DISTRICT OF EAST JAVA

*by* Ima Widha R

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# FINANCIAL PERFORMANCE OF ISLAMIC RURAL BANKS AND CONVENTIONAL RURAL BANKS IN MAGETAN DISTRICT OF EAST JAVA

Anggita Langgeng Wijaya, and Parji  
IKIP PGRI MADIUN, East Java, Indonesia  
Email:Gonggeng14@gmail.com

**Abstract :** This research has purpose to know the difference of financial performance between conventional rural banks (Bank Perkreditan Rakyat) and Islamic rural banks (BPR Syariah) in Magetan district, east java, Indonesia. Population in this research is all of Islamic rural banks and conventional banks in Magetan district year 2010 – 2013. Sample is taken by sampling purposive method. Data is obtained from quarterly financial report which is published on the website of Indonesian Bank. The data analyzing uses t- test. The result of this research is significant financial performance difference between Islamic rural banks and conventional rural banks in East Java Magetan district. Conventional rural banks have higher profitability than Islamic rural banks.

**Key words:** *Financial Performance, Conventional Rural Banks, Islamic Rural Banks, Magetan.*

## INTRODUCTION

This research aims to examine the differences in financial performance between conventional rural banks and Islamic rural banks in Magetan district of East Java. Financial performance is the ability of company to get earnings. According to Faruk and Alam (2014), banking plays very strategically role in the economic development of country. Tan and Floros (2014) said that company profitability is a function from the behavior risks taken by bank. Good company profitability will show good risk management system, strong credit control and good supervision.

Haque (2010) states, Islamic banking has grown quickly and substantially in recent decade. Operation of Islamic banking based on Sharia/ Islamic principal which prohibit acceptant and interest payment because it is believed as usury. However, from operational business side, product and service that are offered can be said as conventional bank. The development of Islamic banking has existed since the increase of oil price in the Middle East in 1973 (Swartz, 2011), while in Indonesia Islamic banking has begun since 1992 (Ika and Abdullah, 2011).

Anwar (2010) explains that in Indonesia in year 2010, there were more than fifteen banks which have double operational system that is operate activity as a conventional bank and also operate Islamic banking system. Good

development in Islamic banking is also growing to the area with the advent of rural banks with Islamic base. Handan and Wijaya (2006) say that rural banks based on Indonesian Republic law number 10 of 1998 is a bank conducting conventional business or based on Sharia principle that do not give service in payment traffic.

Banking in regency has tight level competition in operational terms. Conventional rural banks and Islamic rural banks compete with national banking, cooperatives and regency financial institution. The appearance of Islamic rural banks has become an interesting study in research, especially about how Islamic rural banks financial condition if it is compared with conventional banks. This research tries to give contribution to the research before which compares financial performance between conventional rural banks and Islamic rural banks in Magetan district, East java.

## THEORITICAL BACKGROUND

Soylu and Durmaz (2013) state that development of Islamic banking finds awakening moment for about 30 years. According to Islamic's economic principles, Islamic banking does not give interest to depositor and also does not charge interest on money lend. Soylu and Durmaz (2013) state that it's will be so interesting to compare between Islamic banking performance which is not based on interest and conventional banking which is based on interest.

Ismal (2009) explains that Islamic banking industry in Indonesia is something so prospective. It is proved by the growing of Islamic banking in second recent decades. The change of environment business demand has forced Islamic rural banks to have liquidity management in order to optimize the company performance. The development of Islamic economics does not only give an impact on number of Islamic banking in nation level but also there is a phenomenon of the growth of Islamic banking in regency through rural banks on Islamic/ Sharia base.

Jikrillah (2010) states that rural bank is key component in advancing the middle and micro enterprises (Usaha Menengah Kecil dan Mikro/UMKM). Complicated bureaucracy that usually becomes the main obstacle for UMKM to get access fund lead it to obtain solution through rural bank service. The process of simple and easy credit service makes rural banks can be more believed by UMKM actors. Important role run by rural banks to UMKM, in line with government strategy to make small middle enterprises

and micro as the spearhead of the national economic growth. For a strategic role that is different with general banking, rural banks industry with high - efficiency- level is so important, because it has positive impact to another sectors. The rural banks target is serving the needs of farmers, ranchers, fishermen, small business owners, employees, and retirees for this target cannot be affordable by general bank and to realize equalization of banking service. Equalizations of performance chance, equalization of income, make them do not fall into the hands of loan sharks (Jakrillah, 2010).

Special characters of rural banks to give banking services to UMKM in village areas and suburbs are so hoped can increase their roles and contribution to maximize rural banks role. To expand the rural banks role in supporting UMKM and face competition between financial institutions, so performance of rural banks financial need to be improved. Rural banks as the institution under Indonesian banks supervision, they are asked to maintain their financial performance related to applicable regulations, if they still want to operate (Adriyan and Supatmi, 2010).

Seeing the role of rural banks that is very important for the lower middle society, researchers give value need to do research about banking financial performance as effort to protect consumer from unhealthy banking practice. According to Jakrillah (2010), coaching and supervision of banks is done by Indonesian Bank. Periodically all of banks should deliver report related to specified criteria for assessment's instrument of health and performance. Banks are charged with the obligation to provide transparent information to the bank customers either associated with transactions conducted by the customer or information about business activities and condition of the bank, so the bank performance can be known by all parties concerned.

Bejaoui and Bouzgarrou (2014) state that development of technology, globalization of goods service, and also capital market development give big impact for banking financial condition in all countries. The ability to maintain company performance is the main factor determining the success of bank. Financial performance in a bank is influenced by characteristic and specification of banking industry, operation, and macroeconomic condition.

Kamaruddin *et al.* (2008) has done the research about evaluation of banking performance in Malaysia if it is looked from cost control efficiency. Result of this research shows cost control in Islamic bank higher than domestic bank and foreign bank in Malaysia. Siebel Research (2008) finds the Islamic banking in Indonesia has better performance if it is looked from debt ratio side and quality level of portfolio repayment than commercial banks in general. The research result of Ika and Abdullah (2011) shows that during 2000 to 2007, there is a significance difference in liquidity level between Islamic Rural Bank and conventional bank in Indonesia. It shows that in finance, Islamic Rural Banks has a low risk compared with conventional bank.

Ika and Abdullah (2011) explain that the significant growth from Islamic banking gives a chance for academics to make research in Sharia side. One of the cases is comparing

the performance of Islamic Rural Banks and conventional rural banks are if there is a significant difference between performance of Islamic Rural Banks and conventional rural bank in Indonesia and if Islamic Rural Banks have a better performance compared with conventional rural bank. Arora and Raghu (2011) examine about financial performance between Islamic Rural Banks and conventional rural banks in Malaysia. The research shows that profitability from Islamic rural bank is better than conventional banking.

Adriyan and Supatmi (2010) says that annual finance report made by rural bank (BPR) to BI (Indonesian Bank) can be used as basic to analyze the goodness and the weakness of rural bank performance. Al-Tamimi (2010) state that Return on Assets (ROA) is a financial ratio used to assess the financial performance of the company. ROA ratio shows that there is ability of bank management in using available assets to get net income. If the ROA ratio is bigger, it shows the high net income as the indicator of efficient operation in rural bank (Adriyan and Supatmi, 2010).

High interesting from society to use Islamic Rural Banks service will influence the Islamic Rural Banks' financial performance (Arora and Raghu, 2011). However, conventional rural bank first appeared in society is also assessed that it has a better stability in financial performance compared with new Islamic Rural Banks. Al-Tamimi (2010) mentions that although United Arab Emirates is a Islamic country, the marker share of Islamic bank is lower than conventional bank. This situation is interested to be observed to know the comparison of the financial performance between Syariah Rural Banks and conventional rural banks.

Based on the description stated above, the hypothesis of this research can be written below.

H1: There are significance differences of financial performances between Islamic Rural Banks and conventional rural banks.

## RESEARCH DESIGN

Data, population and Sample

Data in this research is taken from quarter financial report published in Indonesian bank website. The population in this research is Islamic Rural Banks and conventional rural banks in Magetan district which is listed in Indonesian bank year 2010 to 2013. Sample is taken by using purposive sampling method.

Definition of Operational Variable

The first variable in this research is financial performance of rural banks. Financial performance is measured by using Return on Assets (ROA) ratio based on the statement of Ika and Abdullah (2011). Return of Assets in this research can be made by using formula written below.

$$ROA = \frac{\text{Net Income}}{\text{Total Assets}}$$

The second variable in this research is bank category. In this research, the researchers make dummy variable which is



meant that 1 for Islamic Rural Banks and 0 for conventional rural banks.

#### Data Analyzing Method

##### 1. Descriptive Statistics

Descriptive statistic in this research is purposed on giving the general description in liquidity grade between Islamic Rural Banks and conventional rural banks in Magetan district which is seen from minimum score, maximum score, average score and deviation standard.

##### 2. T-Test

Hypothesis of this research is tested by using t- test. The analyzing instrument used in this research is independent sample T-Test. According to Santoso (2006), if p value is under 0.05, it means that there is a significant difference between Islamic Rural Banks and conventional banks.

## RESEARCH RESULT

### Descriptive Statistics

The result of statistical test can be seen in the table below.

Table 1  
Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Deviation Standard
ROA	65	-0,06	0,06	0,018	0,214
DUMMY BANK	65	0,00	1,00	0,107	0,312

Total of financial data used in the research are 65 data that consists of 58 financial performance data in conventional rural banks and 7 financial performance data in Islamic rural banks. The financial performance data of ROA has minimum score - 0,06 with maximum score 0,06. The average score of ROA is 0,018 with deviation standard 0,21.

Table 2  
Descriptive Statistics

Variable	N	Kolmogorov-Smirnov Z	P-Value	Distribution
ROA	65	1,280	0,076	Normal

The result of normality test shows that p score is 0,076. That score is up of 0,05. So, it can be concluded that the distribution data above is normal. Data in this research is distributed normally, so the differential test can be done by using Sample T-Test of independent approach. The result of Differential test can be seen below.

Table 3  
Descriptive Data of Each Bank

Variable	DUMMY BANK	N	Mean	Deviation Std	Error Mean Std
ROA	Con.RB	58	0.0226	0.0142	0.00187
	Islm.RB	7	-0.0241	0.0262	0.00992

Table 4  
T-Test Result

Variable	T	df	Sig (2-tailed)	Mean Difference	Error Difference Std
ROA	7,398	63	0,000	0,0468	0,0063

Table 3 shows that conventional banks have average of ROA 0,022 with deviation standard 0,014. On the other hand, Islamic Rural Banks have average of ROA -0,024 with deviation standard 0,026. The differential test in table 4 shows that t score is 7,398 with p value 0,000. That differential test shows a significant difference. It means that there is significant difference of financial performance between Islamic Rural Banks and conventional rural banks in Magetan district in year 2010-2013. The hypothesis in this research is supported. Conventional rural banks have higher profitability on average compared with Islamic Rural Banks. If it is seen from the financial performance, conventional rural banks in Magetan district have a higher financial performance compared with Islamic Rural banks. This research does not support the research result of Arora and Raghu (2011) which says that Islamic banking has a higher profit compared with conventional rural banks. The researchers state that Islamic rural Banks are new, especially in Magetan district, so the operational activities are not as good as conventional rural banks that are firstly appeared. Islamic Rural Banks, in the beginning of operation, get losses, so in the research shows a significant difference when they are compared with conventional rural banks in the case of financial performance.

## CONCLUSION

This research is purposed on knowing the differences of financial performance between Islamic rural Banks and conventional rural banks in Magetan district in year 2010-2013. The research result shows that:

1. There is significant difference of financial performance between conventional rural banks and Islamic rural Banks in Magetan district in year 2010-2013.
2. Conventional rural bank in Magetan district during 2010-2013 have higher profitability compared with Islamic Rural Banks.

This research does not consider the life cycle phase of rural banks that can influence the financial condition of those rural banks, the research is only done in Magetan district of east Java, this research result cannot be used to do generalization. The next research is suggested to enlarge the area of the research in other district in East Java, extend the research period and consider the life cycle phase of banks as research variable.

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