Three research method approaches: musharaka financing performance model in Indonesian Islamic banks

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Abstract

Purpose – This paper aims to create a model of musharaka financing performance and Islamicizing agency theory to explain issues related to musharaka financing and propose solutions to these problems.

Design/methodology/approach – This research focuses on Islamic banks located in East Java Province, Indonesia, as the population for investigation. This study used primary data collected through a questionnaire instrument. The research adopts a mixed method approach, integrating quantitative data using the smartPLS program, qualitative data using a case study and kasyif research.

Findings – This research revealed that employee competence, Islamic business ethics and monitoring significantly impact the risk of musharaka financing. In contrast, information asymmetry does not significantly influence the risk of musharaka financing in Islamic banks. On the contrary, information asymmetry, Islamic business ethics and monitoring significantly affect the performance of musharaka financing. However, employee competence and risk of musharaka financing do not significantly influence the performance of musharaka financing in Islamic banks.

Research limitations – The responses to the questionnaire are analyzed from the perspective of directors and financing managers of Islamic banks who possess expertise in management and act as financing providers. However, musharaka partners who receive financing may have different perceptions and experiences of implementing musharaka financing.

Practical implications – Financing managers and directors at Islamic banks need to minimize the risk of musharaka financing and alleviate information asymmetry by enhancing employee competence and selecting musharaka partners capable of adhering to Islamic business ethics.

Social implications – Partners of musharaka financing should enhance their Islamic business ethics. Next, other researchers should improve this study by expanding the research locations, increasing the sample size, incorporating additional variables and involving musharaka partners as respondents.

Originality/value – It is a new research using three methods to construct a model of musharaka financing performance. The research refines agency theory by integrating Islamic values into Sharia agency theory.

Keywords Islamic Bank, Performance, Musharaka, Agency

Paper type Research paper

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Introduction

A profit and loss-sharing system is regarded as a mechanism that replaces the interest-based system (Siddiqui, 2005). This system, serving as an alternative to interest in Islamic (Sharia) financial transactions, involves financial contracts. Active parties, especially in mudarabah and musharaka, are called mudareb and musharik. Meanwhile, the passive party, identified as the principal, is an Islamic bank. Suppose each party acts to maximize their interests. In that case, there is a possibility of concealing information from both sides, leading to information asymmetry between the agent and the principal, thus resulting in agency conflicts. Consequently, financing through a profit and loss-sharing system may give rise to problems triggered by agency conflicts. However, as financing via the profit and loss-sharing system is conducted by Islamic banks and financial institutions operating under Sharia (Islamic) provisions, it raises a question that warrants investigation: Can the problems in profit and loss-sharing system financing be adequately explained using agency theory?

Musharaka poses a high-risk probability of encountering moral hazards due to unbalanced information, which may lead to moral hazards (Sarker, 1999). Islamic banks may face challenges because of limited information regarding project quality. Borrowers hold privileged information about the management’s activities. Providing an accurate portrayal of the project’s likelihood of success to the bank proves challenging as each borrower tends to overstate the project quality. Difficulties in assessing borrower quality can result in adverse selection problems, mainly when competing loan funding sources exist. Borrowers who are aware that their projects yield low profits may prefer financing through a profit and loss-sharing system, as it offers higher returns due to lower capital costs. Under a profit and loss-sharing contract, borrowers may be incentivized to manipulate reported profits through creative accounting.

Drawing on insights from agency theory, positive accounting and Sharia accounting theory regarding performance and risk in musharaka financing products at Islamic banks, it becomes imperative to undertake a research study on musharaka financing risk and performance as primary research variables. Consequently, the main variables for performance and risk of musharaka financing are derived from agency theory, positive accounting and Sharia enterprise theory. Collectively, these three theories serve as a comprehensive framework (grand theory) for understanding both the risk and performance aspects of musharaka financing.

Saeed (2004) found that the proportion of profit and loss-sharing-based financing (musharaka and mudarabah) ranged from 20% to 30%, while the amount of nonprofit and loss-sharing-based financing (murabahah, ijarah and so on) ranged from 80% to 70%. Yumanita and Ascary (2005) explained that nearly all Islamic banks worldwide are dominated by murabahah financing products. Dar and Presley (2000) stated that according to international Islamic bank associations, the profit and loss-sharing system accounts for less than 20% of the financing conducted by Islamic banks worldwide.

Research gaps

There are inconsistencies in the research findings regarding the impact of employee competence on risk and performance. The study by Wardayati et al. (2014) revealed that the competence of a Sharia account officer has a significant effect on the risk associated with mudarabah financing, in contrast to research by Hasan et al. (2017), which indicates that the competence of Sharia account officers does not affect variables related to murabahah financing risks. In addition, the research by Wardayati et al. (2014) concluded that the competence of Sharia account officers significantly influences mudarabah financing.
performance, differing from a study conducted by Mawarni et al. (2023), which found that competence has no significant effect on performance.

There are inconsistencies in the research results regarding the impact of monitoring on information asymmetry, risk and performance. Previous research found that analysts serve as external monitors for reducing information asymmetry (Liu, 2023). However, previous research yielded different results, showing that an independent audit committee does not indicate an impact or correlation with asymmetric information (Gantyowati and Nugroho, 2009). Research conducted by Lubis and Siregar (2023) demonstrated that effective internal control can minimize risk by implementing a risk-based audit. However, this differs from the results of research conducted by Rismayanti and Nadhirah (2022), where external audit variables do not influence the effectiveness of enterprise risk management. According to a study by Hanifah (2020), it was determined that the size of the audit committee has no impact on financial performance, in contrast to the results conducted by Affuso et al. (2023), which indicate that parental monitoring directly and positively affects academic performance.

There are inconsistencies in the research results regarding the effects of Islamic business ethics (IBE) on information asymmetry, risk and performance. The studies by Wardayati et al. (2014) concluded that IBE significantly affected information asymmetry in mudarabah financing. However, research conducted by Prawitasari and Putra (2019) found that the morality of management had no negative effect on accounting fraud. Research by Darwish (2019) discovered a strong relationship between ethics and risk management. However, research conducted by Andriani et al. (2022) found no significant influence between character and problematic financing. Roziq (2012) concluded that IBE did not impact the performance of mudarabah financing. In contrast, research results conducted by Doman and Sitorus (2023) indicated that business ethics positively and significantly influenced company performance. Randio et al. (2023) found that their research revealed that applying business ethics affects employees’ performance.

There are gaps in the research results regarding the influence of information asymmetry on risk and performance. Hasan et al.’s (2017) study indicated that information asymmetry does not affect the risk of murabahah financing, whereas research conducted by Ivic and Ceric (2023) found that risks stem from information asymmetry in construction projects. However, the study by Wardayati et al. (2014) concluded that information asymmetry significantly affects the performance of mudarabah financing. In addition, Khatali’s (2020) study demonstrated that information asymmetry does not significantly and negatively influence firm performance.

Inconsistencies have emerged in research findings regarding the impact of risk on performance. Roziq (2012) found that the risk associated with mudarabah financing has no significant effect on its performance. However, this contrasts with the research results of Alabdullah (2023), which found that implementing risk management practices positively influenced corporate performance. Furthermore, research results indicate that credit risk management significantly contributes to robust financial performance (Orichom and Omeke, 2021). Considering these identified research gaps, we are prompted to analyze and develop the musharaka financing performance model and the determinant variables influencing musharaka financing performance in Islamic banks. This survey research will be conducted in the province of East Java, Indonesia, which was selected due to the extensive presence of Islamic banks, where a substantial proportion of the population adheres to the Muslim faith. This study aims to determine, test and substantiate the influence of:

- employee competence on the risk and performance of musharaka financing;
monitoring on information asymmetry, risk, and performance of musharaka financing;
IBE on information asymmetry, risk and performance of musharaka financing;
information asymmetry on risk and performance of musharaka financing; and
risk on the performance of musharaka financing.

This research builds upon previous studies, including Roziq (2012) investigation into the performance of mudarabah financing, Roziq et al. (2020) examination of variables determining the financial performance of both conventional and Islamic banks, and their differentiation. In addition, Roziq et al. (2019) explored the influence of the intermediation function, capital structure and risks on the financial performance of Islamic banks in Indonesia. This research sets itself apart from prior studies by using a mixed-methods approach, incorporating quantitative, qualitative and kasyif methodologies. Quantitative methods involve explanatory research using the smartPLS program, whereas qualitative methods use case studies to address issues related to musharaka financing. Kasyif’s methods are used to integrate Islamic values into agency theory, contributing to the development of Sharia agency theory. This research aims to create a model for musharaka financing performance, address issues related to musharaka financing and further refine Sharia agency theory.

Literature review

Agency theory
Agency theory explains the relationship between the company owner, the principal and the company managers as the agent (Jensen and Meckling, 1976). However, the relationship between the two parties is not balanced because agents have more information (complete information) than principals, thus causing information asymmetry. Pratamasari (2003) and Rahmawati and Qomariyah (2007) confirmed the existence of agency theory on asymmetric information between agents and principals. The essence of the benefits of an Islamic business contract is to guarantee the efficacy of both partners (parties) in the contract. When the contract or production process faces principal–agent problems due to unbalanced information and moral hazard, Islamic contracts also easily minimize this. The agent will be paid for their work and ability. It can be said that in the Islamic economy, companies use business contracts designed by Sharia to minimize principal–agent problems. The public will benefit from the welfare motives of principals and agents (Choudhury, 2001).

Sharia enterprise theory
Sharia enterprise theory elucidates the equilibrium between selfish and altruistic values in conducting business. Zakat can serve as one solution to maintain this balance (Triyuwono, 2006b). The implications of this equilibrium lead the Sharia enterprise theory to consider the interests of individuals (in this case, shareholders) and other parties. Compared to entity theory, Sharia enterprise theory has a broader scope of accountability encompassing man, nature and God (Triyuwono, 2006a). Sharia enterprise theory is predominantly used within Islamic banking institutions. As Islamic banks operate under Sharia ethics, they prioritize adherence to processes over mere outcomes. The operational procedures of Islamic banks must align with Sharia law, with outcomes serving both as acts of worship and contributing to the welfare of all stakeholders. The Sharia enterprise theory is also intertwined with agency theory, as moral hazard may arise between parties engaged in contractual relations as principals and agents. In mudarabah financing, the agents are the bank customers or
business partners, whereas the principals are Islamic banks. However, there are additional factors influencing agency theory in Islamic banks. Muslims uphold religious values of honesty and trustworthiness in all aspects of life, which consequently influence the behavior of involved parties to act ethically as Muslims and avoid causing harm to one another.

*Musharaka financing*

According to *Bank Indonesia (2011)*, musharaka financing is a form of cooperation between Islamic banks and customers for a specific business venture. Each party contributes a portion of the funds, with profits shared according to the agreement, while losses are borne proportionately to the contribution of each party.

*Employee competence*

Competence is defined as the amalgamation of knowledge, skills, attitudes, behavior or personal qualities necessary for each employee to perform their job optimally (*Sutaryono, 2006; Agung, 2007*). The competence of employees in the financing section is characterized by a combination of knowledge, skills, attitudes, behavior or personal qualities required by every employee of an Islamic bank to fulfill their duties effectively.

*Musharaka financing performance*

*Helfert (1991)* defined performance as a result or achievement achieved by the company in a certain period that reflects the level of the company’s soundness. *Harahap (2007)* proposed that performance must be informed in Islamic accounting, including financial performance, performance of social commitments and Sharia performance.

*Islamic business ethics*

*Ansorullah (2007)* explained that IBE comprise the characteristics of shiddiq (honesty), istiqomah (consistency), fathonah (competence), amanah (accountability) and tabligh (teaching by role model), which business people should strive to emulate.

*Information asymmetry*

*Scott (2015)* defined information asymmetry as a condition in which there is an imbalance in the acquisition of information between parties in business transactions, with certain parties possessing an information advantage over others. *Rahmawati and Qomariyah (2007)* elaborated on two types of information asymmetry: adverse selection and moral hazard.

*Musharaka financing risk*

*Fardiansyah (2006)* defined the risk of musharaka financing as altering partners’ quality, potentially leading to an increase in nonperforming financing because of the partners’ inability or unwillingness to repay musharaka capital.

*Monitoring*

*Hikmat (2020)* defined monitoring as collecting and analyzing information based on systematically and continuously determined indicators about activities/programs. This enables the identification of corrective actions to improve the program/activity further.

**Methodology**

The method utilized in this research uses a mixed-method approach (triangulation), integrating quantitative and qualitative research alongside Kasyif analysis. Quantitative
research emphasizes theory testing by measuring research variables with numerical data and analyzing them using statistical procedures (Indriantoro and Supomo, 2016). The quantitative method uses explanatory research, elucidating the relationship between research variables and testing formulated hypotheses (Singarimbun and Effendi, 2011).

Qualitative methods use case studies to explore solutions for issues related to musharaka financing. A case study is a research strategy, a comprehensive methodological approach used to gather, organize and analyze specific findings about individual cases (Creswell, 2015). The utilization of qualitative analysis to address the problem formulation in this research does not involve hypothesis testing.

Kasyif analysis is used to evaluate the alignment between the verses of the Qur'an, as-Sunnah, and their practical implementation in the field (Purwanto et al., 2022). This analysis addressed aspects that quantitative and qualitative analyses could not adequately cover to derive more detailed and comprehensive conclusions (Irawan et al., 2015).

The population in this study comprises Islamic banks located in East Java Province, Indonesia. The sampling method used is purposive sampling, with the condition that Islamic banks in East Java Province, Indonesia, are selected. Primary data were gathered using a questionnaire instrument. The research respondents consist of financing managers and heads of Islamic banks, totaling 67 individuals in East Java Province, Indonesia.

The analysis technique used in this quantitative research is partial least squares (PLS). PLS is a multivariate statistical technique that compares multiple dependent and independent variables (Abdillah and Hartono, 2015). Ghozali (2014) defined the formal PLS model as representing the variable as a linear aggregate of the indicators. Weighted estimates used to create variable score components are derived based on the specifications of the inner and outer models. The outer model in this study encompasses convergent validity, discriminant validity, composite reliability and Cronbach’s alpha. The structural model (inner model) aims to predict causal relationships between latent variables and assesses collinearity between constructs and the model’s predictive ability. Several criteria are used to evaluate model predictions, including multicollinearity, VIF, goodness-of-fit model tests and path coefficients. The inner and outer models are briefly described in Figure 1.

**Results**

**Outer model**

The reflective indicators of the outer model are tested using the convergent validity and discriminant validity tests of the indicators, as well as the composite reliability for block indicators. Here is the analysis and explanation of each outer model test.

These convergent validity results are calculated using PLS. Individual reflective measurement is considered high if the correlation with the measured construct is higher than 0.70 (Ghozali, 2014). The output result from stage I of SmartPLS showed EMCOM2, EMCOM3, MFR1, MFR2, MFR3, INAS1, INAS2 and INAS3 indicator that has low convergent validity is removed from the model because their correlation is less than 0.70 and is deemed insignificant. The model is recalculated by bootstrapping for the second time. The output result from stage II of SmartPLS is shown in the SmartPLS graph in Figure 2.

Based on Figure 2, the only significant indicator from the employee competence variable is EMCOM1. All monitoring variable indicators (MON1, MON2 and MON3) are significant. All indicators from the IBE variable, namely, IBE1, IBE2, IBE3, IBE4 and IBE5, are significant. INAS4 and INAS5 as indicators from information asymmetry variables are significant. The only significant indicator from the musharaka financing risk variable is MFR4. All indicators from the musharaka financing performance variable, namely, MFP1, MFP2, MFP3, MFP4, MFP5, MFP6 and MFP7 are significant.
Based on outer loading in the smartPLS report, it is known that the outer loading indicator value of the employee competence variable EMCOM1 is 1, exceeding the required value of 0.7. The outer loading indicator value of the IBE variable, namely, IBE1 of 0.828, IBE2 of 0.839, IBE3 of 0.850, IBE4 of 0.846 and IBE5 of 0.852, all exceeds the required 0.7 value. The outer loading value of the significant information asymmetry variable indicator is INAS4 of 0.946 and INAS5 of 0.944, exceeding the required value of 0.7. The outer loading indicator value of the musharaka financing performance variable, namely, MFP1 of 0.715, MFP2 of 0.717, MFP3 of 0.730, MFP4 of 0.827, MFP5 of 0.838, MFP6 of 0.751 and MFP7 of 0.805, all exceeds the required value of 0.7. The significant outer loading value of the musharaka

**Source:** By authors
financing risk variable indicator is only MFR4 1,000, which exceeds the required value of 0.7. The outer loading value of the monitoring variable indicators, namely, MON1 of 0.921, MON2 of 0.917 and MON3 of 0.907, exceeds the required value of 0.7. Now, the results meet convergent validity because all loading factors for each construct are above 0.70 and significant at 0.05.

**Discriminant validity**
This validity was determined by comparing the square root of AVE for every construct with the correlation of one construct and the others from the model. The model is sufficient if the square roots of AVE are much more than the correlation between the construct and the other constructs in the model. Tables 1 and 2 below are to be compared to have the result.

The correlation value of latent variables can be seen in Table 2 below.

Based on the comparison of the square root of AVE in Table 1 and the correlation coefficient between variables in Table 2, it can be concluded that the gauges (indicators) used in this study have met the discriminant validity criteria.

<table>
<thead>
<tr>
<th></th>
<th>AVE</th>
<th>Square roots of AVE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee competence</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Information asymmetry</td>
<td>0.893</td>
<td>0.94499</td>
</tr>
<tr>
<td>Islamic business ethics</td>
<td>0.711</td>
<td>0.84320</td>
</tr>
<tr>
<td>Monitoring</td>
<td>0.837</td>
<td>0.91488</td>
</tr>
<tr>
<td>Musharaka financing risk</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Musharaka financing performance</td>
<td>0.594</td>
<td>0.77071</td>
</tr>
</tbody>
</table>

**Table 1.** Average variance extracted (AVE)  
Source: SmartPLS output

**Figure 2.**  
Graphic output result of stage II SmartPLS  
Source: By authors
Reliability test
The reliability of a gauge shows the stability and consistency of an instrument measuring a certain concept or variable (Ghozali, 2014). The reliability test uses Cronbach’s alpha and composite reliability values. For the best result, the alpha value must be larger than 0.7, although 0.6 is acceptable in studies of an explorative nature. The results of the construct reliability test can be seen in Table 3 below.

Table 3 shows the value above 0.7, so it can be stated that the measurements in this study are indeed reliable.

Inner model
Inner model analysis ensures that the structural model built is robust and accurate. The inner model in this research uses multicollinearity, VIF, goodness-fit model test and path coefficient. Here is the analysis and explanation of each inner model test.

Multicollinearity test
The results of testing multicollinearity data with tolerance and VIF values are displayed in Table 4 above. Based on the Table 4 multicollinearity test above, the tolerance value for each variable is greater than 0.1, and no variable has a VIF value of more than 10. The test result concluded that the regression model in this study does not show symptoms of multicollinearity.

Goodness-fit model test
The structural model is tested using the adjusted $R^2$-squared value, i.e. the goodness-fit model test. Table 5 shows that the influence of the monitoring variable model and IBE variables on information asymmetry variables gives an adjusted $R^2$-squared value of 0.295,

### Table 2
<table>
<thead>
<tr>
<th>Latent variable correlation</th>
<th>EMCOM</th>
<th>INAS</th>
<th>IBE</th>
<th>MON</th>
<th>MFP</th>
<th>MFR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee competence (EMCOM)</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Information asymmetry (INAS)</td>
<td>0.151</td>
<td>0.945</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Islamic business ethics (IBE)</td>
<td>-0.241</td>
<td>-0.562</td>
<td>0.843</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monitoring (MON)</td>
<td>-0.301</td>
<td>-0.276</td>
<td>0.529</td>
<td>0.915</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Musharaka financing performance (MFP)</td>
<td>-0.183</td>
<td>0.130</td>
<td>0.389</td>
<td>0.526</td>
<td>0.771</td>
<td></td>
</tr>
<tr>
<td>Musharaka financing risk (MFR)</td>
<td>0.419</td>
<td>0.209</td>
<td>-0.327</td>
<td>0.090</td>
<td>-0.021</td>
<td>1.000</td>
</tr>
</tbody>
</table>

**Source:** SmartPLS output

### Table 3
<table>
<thead>
<tr>
<th>Cronbach’s alpha</th>
<th>Composite reliability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee competence</td>
<td>1</td>
</tr>
<tr>
<td>Information asymmetry</td>
<td>0.880</td>
</tr>
<tr>
<td>Islamic business ethics</td>
<td>0.898</td>
</tr>
<tr>
<td>Monitoring</td>
<td>0.903</td>
</tr>
<tr>
<td>Musharaka financing risk</td>
<td>1</td>
</tr>
<tr>
<td>Musharaka financing performance</td>
<td>0.885</td>
</tr>
</tbody>
</table>

**Source:** SmartPLS output
which can be interpreted that the variability of information asymmetry (INAS) could be explained by monitoring and IBE variables by 29.5%. Other variables outside those studied influence the remaining 70.5%.

Test on the influence of the employee competence variable, IBE variable, information asymmetry variable and musharaka financing risk on the musharaka financing performance variable gives an adjusted $R^2$ value of 0.420, meaning that 42% of the variability of musharaka financing performance is caused by the variability of employee competence, monitoring, IBE, information asymmetry and musharaka financing risk variables. In comparison, the remaining 58% is explained by other variables outside the study.

The model of employee competence variable, monitoring variable, IBE variable and information asymmetry variable on musharaka financing risk variable gives an adjusted $R^2$ value of 0.346 from which it can be inferred that 34.6% of the variability of musharaka financing risk can be accounted for by the variability of employee competence, monitoring, IBE and information asymmetry while other variables outside the one explain 65.4% studied.

Significance test
Tests on the structural model were also carried out by looking at the significance of the influence employee competence, monitoring, IBE and information asymmetry on musharaka financing risk; influence monitoring and IBE on information asymmetry; influence employee competence, monitoring, IBE, information asymmetry and musharaka financing risk on musharaka financing performance by looking at the parameter coefficients, T-statistical values and $p$-significance values (see Table 6).

Discussions
Based on the research results presented in Table 6, this study has discovered that employee competence significantly positively influences musharaka financing risk. These findings

<table>
<thead>
<tr>
<th>Model</th>
<th>Tolerance</th>
<th>VIF</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>EMCOM</td>
<td>0.637</td>
<td>1.571</td>
<td>Not multicollinearity</td>
</tr>
<tr>
<td>IBE</td>
<td>0.611</td>
<td>1.636</td>
<td>Not multicollinearity</td>
</tr>
<tr>
<td>INAS</td>
<td>0.815</td>
<td>1.227</td>
<td>Not multicollinearity</td>
</tr>
<tr>
<td>MON</td>
<td>0.633</td>
<td>1.580</td>
<td>Not multicollinearity</td>
</tr>
<tr>
<td>MFR</td>
<td>0.755</td>
<td>1.324</td>
<td>Not multicollinearity</td>
</tr>
</tbody>
</table>

**Table 4.** Multicollinearity test  
*Source: SPSS Output*

<table>
<thead>
<tr>
<th></th>
<th>$R^2$</th>
<th>$R^2$ adjusted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information asymmetry</td>
<td>0.316</td>
<td>0.295</td>
</tr>
<tr>
<td>Musharaka financing performance</td>
<td>0.463</td>
<td>0.420</td>
</tr>
<tr>
<td>Musharaka financing risk</td>
<td>0.384</td>
<td>0.346</td>
</tr>
</tbody>
</table>

**Table 5.**  $R^2$ overview  
*Source: SmartPLS output*
<table>
<thead>
<tr>
<th>Path coefficient</th>
<th>Original sample</th>
<th>Sample mean</th>
<th>SD</th>
<th>T-statistics</th>
<th>p-values</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee competence -&gt; musharaka financing performance</td>
<td>-0.018</td>
<td>-0.026</td>
<td>0.084</td>
<td>0.213</td>
<td>0.831</td>
</tr>
<tr>
<td>Employee competence -&gt; musharaka financing risk</td>
<td>0.448</td>
<td>0.439</td>
<td>0.122</td>
<td>3.661</td>
<td>0.000</td>
</tr>
<tr>
<td>Information asymmetry -&gt; musharaka financing performance</td>
<td>0.497</td>
<td>0.488</td>
<td>0.120</td>
<td>4.157</td>
<td>0.000</td>
</tr>
<tr>
<td>Information asymmetry -&gt; musharaka financing risk</td>
<td>0.013</td>
<td>0.013</td>
<td>0.161</td>
<td>0.081</td>
<td>0.935</td>
</tr>
<tr>
<td>Islamic business ethics -&gt; information asymmetry</td>
<td>-0.577</td>
<td>-0.586</td>
<td>0.128</td>
<td>4.502</td>
<td>0.000</td>
</tr>
<tr>
<td>Islamic business ethics -&gt; musharaka financing performance</td>
<td>0.429</td>
<td>0.452</td>
<td>0.169</td>
<td>3.486</td>
<td>0.000</td>
</tr>
<tr>
<td>Islamic business ethics -&gt; musharaka financing risk</td>
<td>-0.462</td>
<td>-0.479</td>
<td>0.214</td>
<td>2.162</td>
<td>0.031</td>
</tr>
<tr>
<td>Monitoring -&gt; information asymmetry</td>
<td>0.029</td>
<td>0.035</td>
<td>0.156</td>
<td>0.184</td>
<td>0.854</td>
</tr>
<tr>
<td>Monitoring -&gt; musharaka financing performance</td>
<td>0.432</td>
<td>0.409</td>
<td>0.129</td>
<td>3.339</td>
<td>0.001</td>
</tr>
<tr>
<td>Monitoring -&gt; musharaka financing risk</td>
<td>0.473</td>
<td>0.490</td>
<td>0.167</td>
<td>2.840</td>
<td>0.005</td>
</tr>
<tr>
<td>Musharaka financing risk -&gt; musharaka financing performance</td>
<td>-0.016</td>
<td>0.006</td>
<td>0.130</td>
<td>0.126</td>
<td>0.899</td>
</tr>
</tbody>
</table>

Source: SmartPLS output
align with competence theory, underscoring the imperative of enhancing the competencies of human resources within Islamic banks, particularly those involved in managing musharaka financing products. It urges them to approach their responsibilities earnestly to mitigate musharaka financing risks, as Pardiansyah (2006) and Muins (2006) suggested. Moreover, these findings echo the results of studies conducted by Sugiarto (2004), Sutaryono (2006), Roziq (2012), and Wardayati et al. (2014).

This research has revealed that employee competence does not significantly negatively impact musharaka financing performance. These findings contrast with competence theory, which stresses the importance of improving the competence of human resources in Islamic banks, especially among employees involved in managing musharaka financing products (Arifin, 2006; Hendharto, 2005). However, these findings are consistent with the research conducted by Mawarni et al. (2023), which similarly found that competence has no significant effect on performance.

This research has revealed that monitoring does not have a significant positive impact on information asymmetry. The results of this study diverge from agency theory, which suggests that direct and indirect monitoring can help alleviate information asymmetry (Scott, 2015). Furthermore, the findings of this study align with the research conducted by Gantyowati and Nugroho (2009), which concluded that an independent audit committee does not demonstrate an impact or correlation with asymmetric information.

This research has revealed that monitoring significantly and positively impacts musharaka financing risk. The results of this study are consistent with agency theory, which suggests that direct and indirect monitoring can mitigate business risk (Scott, 2015). In addition, the findings of this research align with the perspective presented by Lubis and Siregar (2023), which demonstrates that effective internal control can minimize risk by implementing a risk-based audit. Furthermore, this study supports the research conducted by Sahabudin and Ikhwan (2021), who discovered that supervision significantly impacts nonperforming loans in BPRs in Central Lombok Regency, using nonperforming loans as credit risk indicators.

This research found that monitoring significantly and positively impacts musharaka financing performance. The results of this study align with agency theory, which suggests that direct and indirect monitoring can enhance financial performance (Scott, 2015). Furthermore, the study’s results align with the views expressed by Affuso et al. (2023), which indicate that parental monitoring directly and positively affects academic performance. In addition, the findings of this study support the research conducted by Karnawan and Supratikta (2022), who discovered that supervision significantly and positively affects employee performance.

This research found that IBE significantly reduce information asymmetry. The findings of this study align with Sharia enterprise theory, which emphasizes the necessity for musharaka partners to adhere to IBE to mitigate information asymmetry issues (Abdelhamid, 2005; Bussmann, 2003). In addition, this study supports the research results conducted by Joseph (2004), Sufi (2007) and Wardayati et al. (2014).

This research found that IBE significantly reduce the risk of musharaka financing. The findings of this research align with Sharia enterprise theory, which emphasizes that musharaka partners must adhere to IBE to mitigate information asymmetry issues and minimize the risk of musharaka financing (Effendi, 2007). In addition, the findings of this study support the research conducted by Darwish (2019) and Sholihin (2020).

This research found that IBE significantly and positively enhance musharaka financing performance. The findings of this research align with Sharia enterprise theory, which emphasizes the necessity for musharaka partners to adhere to IBE to improve musharaka
financing performance (Webley and Hamilton, 2004; LRN, 2006). In addition, the findings of this study support the results of research conducted by Badroen et al. (2006), Randio et al. (2023) and Doman and Sitorus (2023).

This study found that information asymmetry does not have a significant positive influence on musharaka financing risk. This research did not support the positive accounting theory, which suggests that information asymmetry exists between the principal and the agent in musharaka financing products, thereby affecting musharaka financing risk (Karim, 2004). However, the findings of this research align with the study conducted by Hasan et al. (2017), which concluded that information asymmetry does not affect the risk of murabahah financing.

This research found that information asymmetry significantly and positively influences Musharaka's financing performance. The findings of this research support the positive accounting theory, which suggests that information asymmetry exists between the principal and the agent in musharaka financing (Andrew, 2004; Iqbal and Mirakh, 2004). In addition, the findings of this research align with the studies conducted by, Rahmaini and Qomari (2007), Roziq (2012) and Wardayati et al. (2014).

This research revealed that musharaka financing risk does not significantly impact the performance of musharaka financing. The findings of this research align with agency theory, which explains that business risk can reduce financial performance (Scott, 2015). However, the results of this research do not support the relationship between risk and performance, as indicated by Gizycki (2001), Orichom and Omeke (2021) and Alabdullah (2023). These research results align with the study conducted by Roziq (2012), which revealed that the risk of mudarabah financing does not significantly impact the performance of mudarabah financing.

Agency problems in musharaka financing
The qualitative analysis revealed several obstacles in operationalizing musharaka financing faced by the management of Islamic banks in East Java Province, Indonesia. These obstacles contribute to the incomplete or less comprehensive implementation of musharaka financing, which uses a profit and loss sharing system. The challenges include lack of honesty, insufficient transparency in financial reporting, diminishing revenues and escalating costs, sliding fund, partners being closed off to business conditions, reluctance of partners to audit their financial statements and partners lacking understanding of musharaka financing contracts with a profit and loss sharing system.

Policies that Islamic banks need to adopt to overcome obstacles and ensure the success of musharaka financing products include enhancing analysis of business feasibility during the submission process, assessing the character of the owner and business reputation, conducting the financing process prudently, establishing covenants, such as refraining from adding financing, implementing computerized financial reporting, reviewing financial statements and monitoring musharaka funds and the business activities of Islamic bank partners.

Islamization of agency theory in musharaka financing
The results of the kasyif analysis have revealed that agency theory has faced challenges in reconciling the transcendental reality introduced by religion with the rationality empowered by humans. Integrating Sharia ethical values to enhance the applicability of agency theory in elucidating issues related to musharaka financing is crucial. This refinement of agency theory will render it more relevant in addressing challenges within musharaka financing.
Refining agency theory to elucidate phenomena and issues related to agency in musharaka financing is crucial. This refinement involves integrating Sharia (Islamic) ethical values into agency theory, thereby transforming it into Sharia agency theory. This adaptation enhances its relevance in addressing agency problems within musharaka financing. This aligns with the guidance provided by Allah SWT in the Qur’an, specifically in Surah Sad verse 24, and the teachings of the Prophet Muhammad SAW, as narrated in Hadith number 2079 by Bukhari.

This concept is articulated in the Qur’an, Surah Sad, verse 24: “Verily, most of those who form associations, some of them commit injustice to others, except for those who believe and do good deeds; and very few of them.” Furthermore, buying and selling transactions are blessed when both parties are honest and transparent. However, if deception and concealment are involved, the blessings of the transactions are nullified.

The essence of Allah’s words and the teachings of the Prophet Muhammad SAW convey that there is indeed an agency conflict or problem among the parties involved in every contract or agreement. If they engage in treachery or distrust, leading to agency conflict, the blessings are revoked, potentially resulting in increased risk and suboptimal performance. On the contrary, if they adhere to Sharia principles, acting faithfully and trustworthily, blessings accompany them. This ensures that legal risks are reduced and performance can be increased.

Conclusions
Employee competence, IBE and monitoring significantly influence the musharaka financing risk. In contrast, information asymmetry does not significantly affect the risk of musharaka financing in Islamic banks. However, information asymmetry, IBE and monitoring significantly impact the performance of musharaka financing. Nonetheless, employee competence and the risk of musharaka financing do not significantly affect the performance of musharaka financing in Islamic banks in East Java Province, Indonesia.

Theoretically, musharaka financing may seem like a perfect product for Islamic banks and partners. However, achieving this entails having competent employees, an absence of information asymmetry and musharaka partners with solid IBE. While musharaka financing products are considered ideal, it can be concluded that their implementation poses significant challenges. The findings of this research align with both positive accounting theory and agency theory. They are also consistent with Sharia enterprise theory, which emphasizes the importance of musharaka partners adhering to IBE to reduce information asymmetry issues, mitigate musharaka financing risk and improve its performance.

The study further supports the theory of Sharia accounting, emphasizing the necessity for comprehensive performance reformulation, particularly for musharaka financing products and, more broadly, for Islamic banks, by integrating Sharia (Islamic) values into the performance measurement indicators of Islamic financial institutions like Islamic banks. The research results also align with competence theory, stressing the importance of enhancing the competence of human resources in Islamic banking, particularly those handling musharaka financing products, to encourage a conscientious approach to their duties and mitigate the risks associated with musharaka financing.

Research limitations
Not all branches of Islamic banks in East Java Province, Indonesia, offer musharaka financing products with a profit- and loss-sharing system for business capital, despite already offering mutanaqisah musharaka financing products commonly used for Sharia-compliant mortgage financing. It is conceivable that the intended respondents did not
complete the questionnaire because of the busy schedules of Islamic bank branch directors and financing managers. The responses to the questionnaire are analyzed from the perspective of directors and financing managers of Islamic banks who possess expertise in management and act as financing providers. However, musharaka partners who receive financing may have different perceptions and experiences regarding implementing musharaka financing.

Implications
Improvements must be made to agency theory better to understand agency problems and challenges in musharaka financing. The refinement of agency theory should involve integrating Sharia (Islamic) values to enhance its relevance in explaining agency problems in musharaka financing. Through kasyif, qualitative and quantitative analysis, it becomes evident that there is a necessity for the internalization of Islamic values in agency theory or the reconstruction of agency theory into Sharia agency theory.

Directors and financing managers at Islamic banks need to mitigate the risk of musharaka financing and alleviate information asymmetry by enhancing employee competence, closely monitoring businesses financed through the musharaka system and selecting musharaka partners capable of adhering to IBE.

The Financial Services Authority, as a regulator, must supervise every musharaka financing practice to ensure compliance with Sharia principles. Partners of Islamic banks receiving musharaka financing should enhance their IBE to facilitate adherence to and fulfillment of the terms in the musharaka financing contract. Ensuring that all information is communicated openly, honestly, and responsibly is crucial for minimizing musharaka financing risk, ultimately contributing to the improved performance of musharaka financing.

Another researcher should further develop this research by expanding the research locations, increasing the sample size and incorporating additional variables. Future study endeavors should involve musharaka partners as respondents to contribute data and information for analysis, thereby refining and enriching the findings of this research.

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