



The Effect of Funding toward Financing and Islamic Bank Social Performance in Indonesia

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Abstract

Islamic economy, especially in Islamic Banking and monetary activities, able to grow and develop rapidly in economic crisis era in Indonesia that happened since 1997-1998. This study is based on the role of Islamic bank in running tijarah function both in economy and social activities that gathering the fund then channel it to clients to achieve an optimal performance, that is, welfare. The objective of this study is to prove and analysis the effect of funding toward financing and Islamic Bank Social Performance in Indonesia.

Islamic bank funding is measured by composition indicators and wadiah and mudharabah fund toward total funding. While financing is measured by composition indicators murabahah, istishna', ijarah, mudharabah, musyarakah, and qard toward total financing. While social performance is measured by Financing Ratio indicator for small and middle business toward total financing, the total ratio of Zakat, Infaq and Shadaqah (ZIS) with profit before Zakat and tax, the total ratio of Managing Revenue (executives) toward total employee's income, total ratio of Managing and Employee's Revenue toward total cost of operational and the ratio Qardul Hasan toward total financial.

The result of empirical study shows that a high funding has an important role and effect in increasing Islamic Bank financing. Indonesian Islamic Banking also able to do its social function. This is proven by the financing that has an important role and effect toward its social performance. This is proves that Islamic Banks in Indonesia seek to balance its socio-economy function in the world and the next world (surah A1 Qashash: 77).

Key Words : Funding, Financing, Social Performance, Islamic Bank

INTRODUCTION

Background

The growth of Islamic Banking in Indonesia was quite massive and has the potential continues to grow in the future. The growth rate of Islamic banking business volume averaged between 15-20% per year. Besides that, Islamic banking intermediation was still running well enough at the optimal level, reflected in Financing to Deposit ratio reached 89.9%. (Booklet Perbankan 2011, Bank Indonesia).



The Islamic Banking in Indonesia had a role in supporting the implementation of national development, such as to support the real sector through financing transactions according to Islamic principles and real (intermediation function), which supports the implementation of national development to ensure equal distribution of prosperity. Besides that, Islamic banks also performed social functions such as accepting the zakat, donation, charity, and other grants to be distributed to the zakat management organization, and as a form of Islamic financial institutions which receive cash waqaf.

According to Imam Al Ghazali, the primary goal of Islamic-law is to encourage human welfare, to ensure the protection of religion (*diin*), self (*nafs*), mind (*aql*), generation (*nasl*) and property (*maal*). What are the guarantees the five of them is to protect the public interest (Chapra, 2000). The tasks of Islamic-law are oriented to the realization of human purposes consisting of the benefit of primary, secondary and tertiary (Qardhawi, 2003). The basic of Islamic-law are wisdom and human welfare in the world and the hereafter. The beneficial are indicated in justice, compassion, prosperity, and perfect wisdom. Any deviation from justice will be poverty and from wisdom to folly is not at all in accordance with Islamic-law (Al Jauziyyah, 1955).

The development of banks and branches, the improvement of assets, income and deposits of Islamic banks is an indication that Islamic-law is strong enough in Indonesia. The Islamic bank performance is influenced by Islamic principles (Rosly, 2004). This is also in accordance with the results of a study from Sudin Haron (1996) that all three sources of funding (*current, savings and investment deposits*) which is based on Islamic-law principles has a positive effect on profitability. The bigger the deposit placed by the customer, the greater the bank earned income.

The implementation of Islamic-law principles in institutions and Islamic banking, was developing rapidly in 20 years recent, it indicated that banks and institutions based on Islamic-law principles could be an alternative global economic institutions. Some research on the effect of the application of Islamic-law principles to the performance of the Islamic banks in Indonesia showed significant positive results that the higher the level implementation of Islamic-law principles provide the higher influence on performance (Mooduto, 2006), Suyanto (2007) and Munadjat (2012).

In carried out its functions, the Islamic bank is not only intended to benefit but also should consider to the interests of the environment in order to help achieve *falah*, because Islam commands to run Islam *kaffah* as mentioned in the Al - Qur'an surah Al Baqarah verse 208 the following:



يَا أَيُّهَا الَّذِينَ آمَنُوا ادْخُلُوا فِي السِّلْمِ كَافَّةً وَلَا تَتَّبِعُوا
خُطُوَاتِ الشَّيْطَانِ إِنَّهُ لَكُمْ عَدُوٌّ مُّبِينٌ ﴿٢٠٨﴾

"O you who believe, enter you into to the whole of Islam, and do not you follow the steps of devil. Verily devil is an outright enemy for you "(QS2; Al Baqarah:208)

Sarker (1999) stated that the banks using Islamic-law principles to provide efficient service to the nation, if the banks were supported by law and banking regulations are appropriate. Therefore we need a new model of the development of Islamic finance with the more authentic and intelligent idea related with economic and financial system is really based Islamic morals. Correction and refinement of Islamic finance rather how and how much the contribution to the development that focuses on the impact of welfare and social justice, not only on financial performance.

Research Problems

The measurement of Islamic bank performance in Indonesia using a measurement of bank rating known as CAMEL, it was the performance indicator that measure about the level of Capital (Capital), Asset Quality (Asset), Management (Management), Earning (Earning), liquidity (Liquidity) and Sensitivity to market risk (Sensitivity to market risk). Since 2007, it was added supporting indicators including compliance with Islamic-law principles (contained in the Bank Indonesia Regulation No.13/2/PBI/2011).

The performance appraisal using the CAMELS did not measure the impact of the bank's performance toward the benefit to *stakeholders* and the environment. Issues that would be researched in this study was formulated as follows: Is funding has a significant effect on the financing and performance social of Islamic banks in Indonesia?

LITERATURE REVIEW

Enterprise Theory of Islamic-law

The company's goal in general is to maximize profit, as if the ultimate goal of the company operational is only seen at the end of the income statement. High net profit is the main goal (management) of a company that also be of interest for company owners / stockholders (*stockholders*).

Cooper and Sherer (1984) saw that there were errors in the basic assumptions of accounting today was still based on the interests *stockholders*. According to them, the interests of stockholders or management companies dominated the economic consequences of accounting reports although there was a recognition on the



conceptual level approaches that there was existence of other groups in society (*stakeholders*).

Sarker (1999a) and Yusof and Amin (2004) explained that the company's goal was *Falah*, it was the achievement of happiness in the world and the hereafter or the material and spiritual welfare. The achievement of *Falah* or well-being according to Islamic-law (*Syariah*) is the main focus of human activity in the world. So Islamic manufacturers as well as Islamic consumers, will try to maximize welfare in the welfare of the world as well as in the hereafter. The companies with Islamic ethics should not only creating material prosperity but also creates mental well-being and spiritual well-being (Triyuwono, 2006b).

Islam is *rahmatan lil alamin* (mercy to all the worlds), this concept requires that welfare created by the company distributed to the beneficiary, the *stakeholders* in a broad sense. Islamic enterprise theory does not only care about the interests of the individual (in this case the stockholders), but also other parties. Therefore Islamic enterprise theory has great concern on a broad *stakeholders*. According to the theory of Islamic enterprise, *stakeholders* include God, man, and nature (Triyuwono, 2006b). God is the highest and to be the main purpose of human life. The second Stakeholder of Islamic enterprise theory is that humans are divided into two groups: *direct-stakeholders* and *indirect-stakeholders*.

Direct stakeholders are those who are directly contributing (both financial and non-financial) to companies such as shareholders, management, employees, creditors, suppliers, customers, governments, and others. While *indirect stakeholders* are those who do not contribute directly to the company, but they have right to the welfare created by the company. They are the recipients of zakat, infaq, and Sadaqah (mustahiq). The Last group of *stakeholders* in Islamic-law enterprise theory is the nature. Nature is party to contribute to the life and death of firms as the God and man (Triyuwono, 2006b). With the wide scope of *stakeholders*, the performance of the organization / company is no longer measured by earnings performance reflecting *stockholder utility* maximization, but the performance of an organization will be measured by the achievements of the welfare of the world-hereafter, material-spiritual, which has a broad concern *stakeholders* include God, man and nature (Sarker, 1999a; Yusofdan Amin, 2004; Triyuwono, 2006b).

Islamic-law enterprise theory balance the altruistic value with egoistic values, the material value with the spiritual values and individual values with the congregation. In Islamic law, in a concrete form of the balance embodied in a form of worship, zakat (Triyuwono, 2006b). The consequences of this equilibrium causes of Islamic-law enterprise theory not only care about the interests of the individual (in this case the shareholders), but also other parties. Islamic-law enterprise theory has a



wider scope of accountability than the entity theory. Accountability in question is accountability to God, man, and nature (Triyuwono, 2006a: 35).

From the description above, it showed clearly that the concept of Islamic banking is very different purpose with a bank that operates with a non-Islamic principles. The consequences of this concept is that Islamic banks performance appraisal system should be designed in line with the concept of objective ethics based on Islamic-law above.

Preliminary Studies and Results

The study of Khan and Mirakhor (1990) on the implementation of banks based on Islamic-law principles in Pakistan and Iran concludes that the bank based on Islamic-law principles have impact on financial stability and does not cause the financial system collapsing or worrying. Other researchers, who examined the Islamic Bank is Sudin Haron (1996). He studied the effects of management policy toward the performance of 13 Islamic banks spread across the world. He found that all three sources of funding (*current, savings and investment deposits*) have affect positively on profitability. The bigger the deposit is placed in the bank by the customer, the greater the bank earned income. The total cost is positively correlated to profitability.

Abdus Samad and M. Kabir Hasan (1997) conducted an explorative study on the performance of Islamic banking in Malaysia. The study has found that Islamic banks in Malaysia have higher levels of liquidity and have a relatively smaller risk are compared with 8 conventional banks in Malaysia. The study also proved that the effect of profit sharing is the most important thing of the bank's customers in determining the bank. Haron and Ahmad (2000) conducted a study on the relationship between interest rate in Conventional Bank and that were deposited in interest-free deposits facility at Islamic Bank System in Malaysia. The result of study was Interest Rate on Conventional Bank has negative relationship with that were deposited in interest-free deposits facility. Rosly and Abu Bakar (2003) observed some experience of Islamic banks (IBS) toward conventional banks (*mainstream*) in Malaysia between 1996 and 2001. This study revealed that the investment / interest margin of mainstream banks was found to be significantly higher than that of the IBS, ROA, PM, NOM, and OER was found to be significantly higher for IBS, which occurred due to a technical failure, it can be observed from the amount of overhead guaranteed by the bank.

Performance assessment for several Islamic Bank in the Middle East was studied by Bashir (1999), he found that the higher of the *leverage* ratio and debt toward asset the higher of the profitability. He also found that foreign-owned banks more profitable than their partner banks. The tax impact negatively on the bank performance. Furthermore, the economic conditions affect positively to the bank



performance. Samad and Hasan (1999), examined the performance of Berhad Islamic Malaysia Bank (BIMB) between 1994-1997. They found that BIMB is relatively more liquid and less risky than a group of 8 conventional banks. The financing model with *Profit and Loss Sharing* (PLS) and *Venture Profit Sharing* (VPS) was not popular in Malaysia, 40% to 70% of the bankers surveyed indicated that the lack of knowledge of the banker in selecting, evaluating and managing projects that benefit a significant cause.

Sarker (1999), conducted a study of Islamic Banking in Bangladesh regarding the performance, problems and prospects. The results of study was Islamic banks could provide efficient service to the nation, if the banks were supported by law and banking regulations were appropriate. The bank using models Profit and Loss Sharing (PLS) in its operations, are highly conducive to economic development. Alam (2000) conducted a study of interest-free financial institutions in Bangladesh, known as the Islamic Bank Bangladesh Limited (IBBL). IBBL showed totally success in both the deposit and investment position since the start of the bank's activities. IBBL using the *mudharabah* and *musyarakat* and to raise funds "but not for investment" IBBL more invested in the commercial sector rather than the small and rural industry.

Ibrahim *et. al.* (2004) presented several alternative of performance measures and reports was used the Islamic bank in accordance with the targets of bank establishment, namely socio-economic justice. The results are based on Islamicity Disclosure Index, Bahrain Islamic Bank has a better performance than Bank Islam Malaysia Berhad. Financial indicators that are used for adherence with the Islamic-law are sharing ratio, the ratio of Islamic investment, the ratio of employee salaries with the director, Islamic income ratio and the ratio of zakat. Meanwhile, the indicator was used in the welfare of Bank Islam employee are salary, education and training. The greater employee salaries, the more prosperity of education and training costs.

Haniffa and Hudaib (2004) conducted a study to uncover the actual practice of institutions that operate based on Islamic principles. The study conducted on the annual report of five institutions based on Islamic-law principles in four gulf states. The study found that the practice of institutions based on Islamic-law was still minimal implementation, lack of clear and consistent, the potential decline in a short time as a function to communicate with Allah SWT, the community, and himself that associate with others and demonstrate accountability downs.

Nafik (2007) conducted a study on the effect of profit sharing and interest on savings, distribution of funds (financing or credit), prices and economic growth. The results of study given the understanding that profit sharing system was different with interest system, both of them had different effects on the economy. Muhammad Suyanto (2007), conducted a study that Implementation of Islamic-law in Islamic



Banking in Indonesia is getting better and consistent and sustainable, it had impact to the higher profitability and greater solvency and more useful for small businesses as clients of the Islamic Bank, increasing the portion of financing and increasing portion of *qordul hasan* and increased *zakat, infaq, shodaqoh* and social activities. And Imam Munadjat (2012) who did the *The Effect of Islamic-law Implementation on Performance and Welfare of Employee and Labor Absorption Bank Islam In Central Java* showed significant positive results on the performance of the application of Islamic principles, employee welfare and labor absorption in Islamic banks.

METHODOLOGY

Population, Sample, Sampling Techniques

The population of study were 3 common Islamic Bank (IB) and 28 Islamic Business Unit (IBU) in Indonesia or the total population was 31. Taken in the study population are Islamic banks which has been operating in over five years, publishing a quarterly financial report.

Based on population criteria specified then there are only 2 IB namely Bank Muamalat Indonesia (BMI) and Bank Syariah Mandiri (BSM) and both of them was taken as a sample. Thus the sampling method can be categorized as a census.

The data were analyzed on a quantitative approach was a secondary data in form of data panel, which is a combination of cross-sectional data and time series data with the quarterly period between the fourth quarter of 2000 to the third quarter of 2008.

Defisini Operational Variables

- Islamic Bank Fund Raising given symbol X is the amount of the public funding undertaken by Islamic banks in Indonesia. Indicators to measure the variable of Fund Raising as follows:

X_1 = Funding of goodness agreement is called *Wadiyah fund*, is the total amount of fund raising with *wadiyah* in quarterly.

X_2 = Funding of business agreement is called *Mudharabah fund*, is the total amount of fund raising with *mudharabah* in quarterly.

- The distribution of Islamic Bank is given the symbol Y1 is the amount of which is distributed by Islamic Bank in Indonesia. The Indicators to measure financing variables are:

$Y_{1.1}$ is the total amount of financing with *murabahah* agreement in quarterly.



$Y_{1.2}$ is the total amount of financing with *istishna'* agreement in quarterly.

$Y_{1.3}$ is the total amount of financing with *mudharabah* agreement in quarterly.

$Y_{1.4}$ is the total amount of financing with *Musharaka* agreement in quarterly.

$Y_{1.5}$ is the total amount of financing with *Ijarah* agreement in quarterly.

- Social Performance of Islamic Bank who was given the symbol Y: are the achievements in the social activities of Islamic banking operations.

Indicators for measuring fund raising variables are:

$Y_{2.1}$ = Total Financing Small and Medium Enterprises (RPUKM) in quarterly.
Ratio of Total Financing Small and Medium Enterprises (RPUKM) with total financing in quarterly.

$Y_{2.2}$ = Total SIZ of profit before tax (SIZL) in quarterly. The total ratio of SIZ with Profit before tax (SIZL) in quarterly.

$Y_{2.3}$ = Ratio of Executive Income to Employees Income (RPEPK) in the same quarterly period.

$Y_{2.4}$ = Ratio of Total Employee Income to Total Cost (RPKTB) in the same quarterly period.

$Y_{2.5}$ = Total Qard and Qardul Hasan (QQH).

Social Performance of Islamic Banks

Bank Islam as a form of economic institutions in the Islamic economy is always inherent in it as an institution of social functioning. To find out how much the commitment of Islamic bank in carrying out its social mission it is necessary to measure the achievement of social performance. The social performance indicators was used in the study are: first, the commitment to the weak economy that measured how much the composition of the funds distribution for Small and Medium Enterprises (SME). Second, the commitment to help those less fortunate in the economy, it was measured by the ratio of *Zakat, Infaq and Sadaqah* (ZIS) with total profits earned. Third, the commitment to the equitable distribution of income to the Human Resources (SDI) is involved with the operations of Islamic banks, is measured by the ratio of earnings management (executive) toward the total income of the employee.



The development of the average indicator of Islamic banks that were sampled during the study period are shown in Table 1 below:

Table 1
The Results Descriptive of Analysis Indicator Variables
Social Performance Every Bank in The Year 2000 to 2008
(In Percentage, %)

Bank	PUKM	RZISL	RPEK	RPKTB	RQHTP
	(Y3.1)	(Y3.2)	(Y3.3)	(Y3.4)	(Y3.5)
Bank Muamalat Indonesia	45.60	1.61	19.93	35.26	1.57
Bank Syariah Mandiri	18.72	1.09	9:22	42.98	1.58
Average	32.16	1.35	14.58	39.12	1.58

The Table 1 showed that the average social performance of Bank Muamalat Indonesia during the period of 2000 to 2008 is greater than the Bank Syariah Mandiri. On the average of social performance ratios is distributed to Small Business at Bank Muamalat Indonesia during the period 2000 to 2008 was 44.06, whereas that of Bank Syariah Mandiri was 18.69. The average of social performance from the ratio of total earnings ZIS can be said is still small, namely Bank Muamalat Indonesia reached 1.55 and Bank Syariah Mandiri was 1.01.

The development of social performance showed that Islamic banks had the commitment and partisanship on Small and Medium Enterprises (SMEs). Table 2 showed that the average of distributed fund to SMEs in year 2000 was 15.50 increase to 42.17 in 2008. The partisanship of Islamic banks toward disadvantaged groups in the economically indicated by the ratio of ZIS toward total earnings, it appeared in 2000 was 0.82, but in 2001 to 2007 had increased and declined again to 4.59 in 2008. ZIS good ratio should be greater than 2.5%, due to the zakat of income is 2.5%. Thus Islamic banks had not implemented their zakat obligation well despite had being a good commitment to SMEs.

Table 2
The Results of Descriptive Analysis on Indicator Variables
Social Performance in Year 2000 to 2008 (in percentage, %)

YEAR	PUKM (Y3.1)	RZISL (Y3.2)	RPEK (Y3.3)	RPKTB (Y3.4)	RQHTP (Y3.5)
2000	15.50	0.82	19.06	49.75	2.28
2001	16.50	1.22	19.06	42.62	1.07
2002	16.25	1.64	19.06	38.51	2.15
2003	17.25	1.69	13.86	40.74	2.00
2004	39.25	1.56	23.69	39.91	1.84
2005	39.75	1.16	9.14	39.79	1.91
2006	44.63	1.53	9.94	34.64	1.83
2007	41.88	0.83	8.86	38.40	0.46
2008	42.17	1.59	14.91	42.22	0.76
Average	30.35	1.23	15.29	40.73	1.59



Trends in social performance of the bank during the period of the study could be explained : financing for SMEs in time by time have a positive trend. Thus the Islamic bank's commitment in the fight against poverty in time by time continue to increase. Because SMEs are the economic efforts of the most labor-intensive, so if the financing of SMEs it is possible the labor absorption will also increase. With the increase in the employment income will increase and will further enhance their welfare.

ZIS payment on Islamic banks, although did not in the required ratio of *zakat* which is 2.5% of the profit before tax reaching *nisab*, but in time by time it indicated a growing trend. This condition is in line with the trend of ROA and ROE are also had positive trends that proportionally fair and could be categorized good. ZIS performance can be categorized not good when the profitability (ROA) and ROE increased but the ratio of ZIS to return decreased. Trends in income inequality between employees with managers (executives) at Islamic banks during the study period had a negative trend. Tren negative meant the income gap between managers and employees of Islamic banks getting smaller or more equitable income distribution.

Islamic banks had been on a mission of Islamic economics well in the fight against injustice, in this case the inequality in income distribution. Islamic banks had been able to balance his role as intermediary *tijarah* (business) and an investment with its role as a social institution that should always create a balance of economic equality and social equality.

The trend of costs for the Humanities Resources (SDI) consisted of medical expenses, education expenses, salaries, wages and other benefits had a negative trend. This condition could be done probably due to an increasing of other costs beyond the cost of SDI had rose higher.

The negative trend of the ratio SDI cost toward the total of operational cost in Islamic bank gave meaning that Islamic banks in operation still considered SDI as the objects of production and SDI is still going on its exploitation. And other possibility of Islamic banks in operation less efficient so the total cost increase is higher than the increase in its cost of SDI.

Qardul hasan had a negative trend (decline), the condition was contrary to the positive trend of ZIS. When ZIS increased, qardul hasan should also increase because the source of qardul hasan is ZIS from Islamic Bank. This condition indicates that the ZIS was collected did not distributed in the form of qardul hasan, may it distributed directly in cash to those who deserve it. Distributing ZIS directly was not prohibited by Islam. It would be better if distributed in more educated way, in the form qardul hasan. With the hope that qardul hasan used for working capital for the mustahiq (ZIS



receiver) so that the economy will be more powerful in the future even was very hoped that someday they're being *muzakki* (ZIS payer).

CLOSING

Conclusion

Based on the analysis and discussion to the results of study can be arranged the conclusion as follows:

1. The higher of funding had impact to the role and influence in increasing financing of Islamic Bank. It showed that Islamic banks in Indonesia was able to encourage people in order did not to consume fortune bestowed by Allah with excessive overage but mostly invested for the welfare of their descendants, as instructed in the holy Qur'an an-Nisa verse 9 and Al An'am verse 141. as well as the hadits narrated by Tirmidzi and Baihaqi.
2. Islamic banks in Indonesia had been able to perform its social function properly it was proved that the higher of financing from the Islamic Bank had increased the role and influence to the social Performance of Islamic Bank.
3. Islamic banks had proved resilient and reliable in the face of widespread economic crisis and the global economy as well as to encourage and create higher social welfare for the people both directly and indirectly related to banking. In business activities to practice Islam with *Kaffah*, the Islamic Bank had implemented the banking system in accordance with the religion and culture of the community and could be further developed in Indonesia, which has a Muslim majority population as well as the largest Muslim country in the world, so that in the future Indonesia will become an model in the development of Islamic economics for both regional and international scale.
4. These studies generally concluded that the funding gave significant effect on the financing and the financing gave significant effect on the social performance of Islamic banks in Indonesia.

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