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Islamic Bussiness Concept in Facing Moral Hazard of *Mudharabah* Financing in Indonesia Islamic Banking (Perspective: Asymetric Information Theory)

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ABSTRACT

In the contract of financing much-needed information asymmetry between the owners of capital (*shahibul mall*) and the manager of the capital (*mudharib*) in order to achieve common interests. One of the indicators that lead to moral hazard is due to asymmetric information or dissimilarity of information provided, and influential in the contract of financing. In a *Mudharabah* financing contract, between *shahibul mall* and *mudharib* provide information asymmetry in favor of the creation of a common interest. This study is a literature with an approach that combines the philosophical and phenomenological approach to look deeply about the material object of philosophy as well as the value, the principle of principles, objectives and economic policy, as well as concepts especially the system of financing which is born of the concept of Islamic business. While the phenomenological approach is used in view of economic development, well illustrated in society through statistical data, as well as those contained in a work of literature. The data source literature in particular are books, journals and articles standard, both with regard to the business concept of Islam which were analyzed using content analysis techniques. As the conclusion, in the *mudharabah* financing contract, asymmetric information is needed between the owner of the capital (*shahibul mal*) and the capital manager (*mudharib*) in order to achieve common interests. And one of the indicators that causes moral hazard is the result of asymmetric information or inequality in the information provided, which affects the *mudharabah* financing contract.

***Keywords**:* Islamic Bussiness Concept; Moral hazard; *Mudharabah*; Islamic Banking.

1. Introduction

Generally, Islamic guidelines on the subject of the work does not allow that followers to work for money as they pleases and with the bad roads, such as fraud, corruption, perjury and other vanity deeds. But, Islam gives them a dividing line between what is and is not allowed in the search for life provision, to prioritize the public good problem, as consensual, so that no party feels wronged in the transaction. This principle was affirmed God in Q.S. An-Nisa verses 29-30 that claims to not eat up the property by way of a false neighbor, in this case the people allowed to do business with roads that have been defined within its limits. People who obtain property by stealing, function mostly for mere pleasure, such as drinking, playing women,

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gambling and others. Conversely, people who are looking for property in a lawful way, usually use their assets for useful things (Rahmat Syafi'i, 2004).

Thus, rapid development of contemporary business, which are intended to benefit the material only. Parameter of religion ruled out, that could be used to gain as much material. It is characteristic of capitalist civilization that worships material usurious. Not surprisingly in business practices within the framework of capitalist ideology-free all-round value. Speculation, usury, manipulation of supply and demand as well as a variety of activities that are prohibited in Islam becomes a natural thing. Therefore, Islam has regulated how a Muslim can use his assets to be useful for the life of the world and the hereafter. It is not complete if the property is only enjoyed for worldly interests and has absolutely no effect on the afterlife, both must receive a balanced portion. Islam views wealth as a way that makes it easier for humans to prosper (Abdullah Fatah, 1989).

According to (Antonio, 2001) argued that not a few products banks to apply accounting principles of sharia business units mostly derived from conventional banking, is where in any of the conventional banking practice by opening branches labeled sharia, it increasingly clear that sharia accounting thrives. whether it is just a mere image or actually orientation is the prosperity of the wider community. Thus, in terms of Islamic banking intermediation showed a very good performance which is nearly approaching 100 percent, it means nearly 100 percent of third-party funds in Islamic banks channeled back to the community (Amin, 2009). Oriented of the statement will be born a muamalah of Islamic banking methods that are *mudharabah*.

In the *mudharabah* financing contract, asymmetric information is one indicator of the interest between *shahibul mall* and *mudharib*. But if one of the parties provide information asymmetry can lead to moral hazard. Moral hazard is not only done by one party alone but both parties can only do the moral hazard. And of moral hazard can have an impact on not achieving the common interest. So, the information asymmetry is very important in *mudaraba*.

According to (Muhammad, 2008) *mudharabah* This is one of the products of Islamic banking. Thus, the Islamic banks to design a system for this result to the formation of unity in business risk and revenue sharing venture between the owners of capital (*Shohibul mal*) who save their money in institutions, as the manager of the institution of capital (*mudhorib*), and the people who need the funds that may be placed on lenders or business manager. In carrying out its intermediary function of financing products as the core product is the backbone of Islamic banks Islamic banking (Darajat, 2007).

In the application of the Islamic banking, *mudharabah* product is put on a revenue sharing system, in which both parties must make a contract related to the percentage of profit before *Shahibul mall* provides capital to *mudharib*. Sharing of benefits in this contract, when the owners of capital (*shahibul mal*) provide capital to the fund manager (*mudharib*) to be managed in the business and results of operations have benefited, then peresentase distribution of profits in accordance with the previously agreed contract.

But in practice, financing in the Islamic bank was founded on the system *mudaraba*, and in fact these systems have often been ignored in Islamic banking operations (Iqbal, et al 1998). One is the emergence of the agency problem, which is where the agency problem arises when an owner of capital (principal) hired a capital owner / proprietor of expertise (agents) to do a job or business but these agents do not gain anything from what he produces (Reichelstein, 1992).

From this emerged a moral deviation / trap moral (moral hazard) which is where the application *mudharabah* often abused, both of the owners of capital (*shahibul mal*) in this case Islamic banking and capital managers / customers (*mudharib*). Form of moral hazard can be deviations from abusing *mudharib* the capital that is given, or from *Shahibul mall* itself is where the owners of capital are not selective in providing assurance to *mudharib*.

2. Literature Review

2.1 Islamic Business Concept

When Islam is believed to be a religious as well as a system, the relevant question to it is "Could Islam provides guidance in business ethics?" With the guidance is expected to give the feel of Islam in business.

The term ethics generally refers to the pros and cons of human behavior. Ethics is the basis of good and bad which becomes a reference for individual decision making before carrying out a series of activities. Ethics are not just normative prohibitions, but rather are the peak of the accumulated operational capabilities of human intelligence. Because it involves the operationalization of human intelligence, ethics is also called a philosophical system, or a philosophy that questions human praxis regarding its responsibilities and obligations (Muhammad, 2008).

Islam has guidelines in directing his followers to carry out the practice. These guidelines are the Qur'an and the Sunnah of the Prophet. As a source of the teachings of Islam, at least can offer basic values or principles of general application in the business adjusted with the times and considering the dimension of space in time. Islam is often used as a model order of life. This of course can be used for further development of an order of life, including the order of business life. Al-Qur'an invites people to believe and practice his demands in all aspects of life often using terms that are known in the business world, such as buying and selling, profit and loss, etc.

2.2 Mudharabah

The meaning of *mudaraba* by (Al-Jaziri, 2004) in terms of etymology (language) is a parable (like) a person who gives (surrender) fully possessions (capital) to others to be used to generate trading profits along with certain requirements and if there is a loss, the loss is borne by the owners of capital.

The other that, by (Suhendi, 2005) *mudaraba* can be interpreted as the existence of a contract between the owners of capital (assets) with the manager of capital, provided that the profits obtained both parties according to the number of agreements approved together. As of the jurists explained that *mudaraba* is the existence of a contract or agreement between two parties (person) to bear, one of the parties submit their wealth (capital) to the other party to be traded with the proviso that have been determined from profit, such as a half or a third of the requirements predetermined.

In kind, (Antonio, 2001) *mudaraba* divided into two types:

1. *Mudharabah Muthlaqah*, namely cooperation undertaken between *shahibul maal* and *mudharib* that very broad and is not limited by the specifications of the type of business, time, and area businesses.

2. *Mudharabah Muqayyadah*, namely cooperation undertaken between *shahibul maal* and *mudharib*, which is where *mudharib* limited to specifying the type of business, time, or

place of business or often referred to as restricted *mudaraba* / specified *mudaraba* is the inverse of *mudharabah muthlaqah*.

The elements in *mudharabah* according to (Sumiyanto, 2005), namely:

1. No party that had the contract: namely *Shahibul mall* (investor) and *mudharib* (manager).
2. The object of contract, it is composed of *ra'sul mall* (capital), *al-'amal* (business), *ar-sprits* (profit) and *al-waqt* (period).
3. *As-Shighat (Ijab qabul)* or Memorandum of Understanding (MoU).
4. Ratio their advantage.

Ratio profit on *mudharabah* according to (Karim, 2006) can be calculated by:

1. Percentage. Benefit ratio should be calculated as a percentage between the two sides and not expressed in nominal value of certain rupiah. So, the profit ratio determined by agreement, not according to the portion of the capital injection from *shahibul mall*.
2. Profit and Loss Sharing. If the profits of big business, both sides got part of that great anyway. If the advantages of a small business, the two sides got small parts as well. If a business in *mudharabah* this disadvantage, not based on the loss-sharing ratio, but based on the portion of capital each party. Thus, because the losses are divided according to the proportion of capital, and because the proportion of capital *shahibul mall* in this contract is 100% then the loss will be 100% also by *shahibul mall* (owners of capital).

2.3 Asymmetric Information Theory

Asymmetric Information is a situation where managers have different information (better) about the condition or prospects of the companies owned by investors. Asymmetric Information and emerged as a result of the unequal distribution of information, in this case between the owners of capital (principal) / *Shahibul mall* and capital manager (agent) / *mudharib*. Ideally, principal obtain the information needed in assessing the results obtained from the business agent. Actually, the measures of success are consumed principal it can not explain the relationship between the success already achieved, the efforts made by the agent.

Asymmetric information between their manager / agent with the owner (principal) can provide an opportunity for managers to perform earnings management (earnings management) in order to mislead the owners (principals) on the economic performance of companies (Richardson, 1998).

Asymmetric Information is divided into two kinds, namely adverse selection and moral hazard. Adverse selection is the managers as well as those in the other usually know more about the state and prospects of the company compared to external investors. A fact that may influence the decision to be taken by the shareholders of the information is not delivered to the shareholders. While moral hazard is an activity undertaken by a manager is not entirely known by shareholders and lenders. So, managers can perform actions outside the knowledge of shareholders in violation of the contract and the actual ethics or norms may not be worth doing.

The explanation of the *mudharabah* capital owners (principal) / *shahibul mall* and capital manager (agent) / *mudharib* should be able to know the information relating to the financial condition and the work done for the sake of making a profit together.

2.4 Moral Hazard

Some of the results of research and theory suggests that moral hazard is one of the main elements that cause conflicts of agency (agency problem) (Mc. Colgan, 2001). In principle, according to (Vaubel, 1983) develops moral hazard when the provision of insurance gives policyholders the opportunity to act recklessly so as to allow the poor conditions which are not expected. The term moral hazard originally used in the field of insurance. (Mulki) said that in the English dictionary meaning of moral hazard is described as the hazard Arising from uncertainty or honesty of the insured.

Moral hazard in the economy is an act of economic agents that cause harm either to themselves or to others. To determine whether an act is moral hazard economy or not, need to learn the principles of Islamic transactions, which is permitted or prohibited the Islamic Shari'a (Hariyanto, 2001). Additionally, Moral hazard can also be interpreted as an act of misappropriation mandate or responsibility for their chance to do so without being noticed by others (Mishkin, 2001). (Susanto, 2010) said that moral hazard would arise when a person or an institution / organization that is not fully consistent and not responsible for his actions, and therefore tend to act less carefully to remove the responsibility for the consequences of his actions to other parties.

The moral hazard that hit banks in Indonesia has made banking industry fundamentals fragile. The existence of a guarantee system does not guarantee the safety of customer funds. Based on experiences in several countries, the existence of government guarantee programs and deposit insurance has caused moral hazard cases in banking to grow (Khan and Ahmed, 2001 in Desty, 2008). Moral hazard in banking can be divided into 2 levels. First, moral hazard at the bank level and the second is moral hazard at the customer level.

Moral hazard at the bank level occurs when an Islamic bank as a *mudharib* is not careful in channeling funds so that it has the potential to create moral hazard on the side of the customer and cause losses. Another moral hazard, namely when a bank does not pay the *shahibul maal* portion according to the ratio set at the beginning of the agreement, or the non-compliance of a sharia bank with sharia principles, can also be categorized as moral hazard. Meanwhile, moral hazard for customers generally occurs in financing products based on equity financing (*mudharabah* and *musyarakah*) or commonly known as profit loss sharing. The *mudharabah* agreement which does not require a guarantee and also gives the mudarib full rights to run a business without the interference of *shahibul maal* and the loss of losses by *shahibul maal* (except management error) results in this financing contract very vulnerable to moral hazard problems.

3. Research Methodology

This study is a literature with an approach that combines the philosophical and phenomenological approach to look deeply about the material object of philosophy as well as the value, the principle of principles, objectives and economic policy, as well as concepts especially the system of financing which is born of the concept of Islamic business. While the phenomenological approach is used in view of economic development, well illustrated in society through statistical data, as well as those contained in a work of literature. The data source literature in particular are books, journals and articles standard, both with regard to the business concept of Islam which were analyzed using content analysis techniques.

4. Result and Discussion

4.1 Relevance The concept of Islamic Business in Addressing the Risk of moral hazard on Mudharabah Perspective Asymmetric Information Theory

Business always play a vital role in social and economic people life of all time, so that business interests will influence the behavior of all individual levels, social, regional, national, and international. Muslims have long been involved in the business world, that since fourteen centuries ago. That phenomenon is not a strange thing, because Islam encourages people to do business activities.

One Islamic business in Indonesia, which is rapidly is Islamic banking. Islamic banking to fame in the 1960s with the name of Mit Ghamr Bank. The Bank operates as a rural-social bank (a sort of financial institutions in the Indonesian village units) along the Nile Delta. The institute is supervised by Prof. Dr. Ahmad Najjar and still small scale in Egypt. However, the institution was pioneering the development of financial and economic system of Islam (Antonio: 1999).

Islamic bank is a bank that its mechanism of action using a mechanism for the results, do not use bank interest. Financing schemes offered by Islamic banks are *mudaraba*, *musharaka* and *murabaha*. Among the schemes offered, *mudaraba* is a scheme that best suits the characteristics of small-scale borrowers. Antonio (2001) "*Mudharabah* is an agreement of cooperation between the two parties where (*shahibul mall*) presents the entire capital (100%), while the other party to become a manager". Business profits in the scheme of financing divided by the agreements set forth in the contract, whereas if the loss is borne by the owners of capital. With financing schemes like these, small entrepreneurs can obtain capital from Islamic banks with a risk of light. So, the scheme of financing is a financing scheme that best suits the small business people who have difficulty problem of capital.

There are several forms of profit-sharing scheme, which in this case is distinguished by sharing revenue calculation basis for each party. Tarsidin (2010) states that Profit-Sharing, Gross Profit Sharing, dan Revenue-Sharing. Tarsidin (2010) further argued that the three schemes for the above result, the profit-sharing scheme (profit-and-loss sharing) is a form of profit-sharing scheme should be used in Islamic banking in financing profit and loss sharing. However, the current profit-sharing schemes are not widely used because most Islamic banks assume that the stakes are high. Islamic banks in Indonesia are now more use of revenue-sharing scheme.

The reason some owners of funds (*shahibul maal*) refused to use the profit-sharing scheme is partly due to the assumption that the profit-sharing scheme was inefficient, whereas the executor of effort (*mudharib*) due to profit-sharing scheme is not incentive compatible rated. Tarsidin (2010) states that the application of the scheme for the results associated with the high cost of monitoring and verification, for the profit-sharing scheme standards (which are not designed so as to achieve the optimization of the parties contracting) is the problem of moral hazard posed great and by implication monitoring and verification costs too great. Therefore, it is of course necessary in the design of the scheme for optimal results, which can efficiently push *mudharib* to use funds in ways and best effort, some of the problems encountered in the implementation of the scheme for the results, which include the high costs of monitoring and verification to address the principal-agent problem in the form of moral hazard. In addition, there is also the problem of adverse selection.

Muhammad (2008) found *mudaraba* contract is a financial contract that is laden with asymmetric information, even asymmetric information is a must have happened in the *mudaraba*. The implications of the asymmetric information problem are that the cost of monitoring and verification on a profit-sharing scheme estimated to be greater than the interest scheme. Monitoring and verification of the amount of profit will determine the amount of revenue for the results so certainly need to do more intensive.

The problem of moral hazard is the biggest problem facing the implementation of the scheme for the results. These problems can be overcome by designing a scheme for results that can efficiently push the contracting parties undertake best efforts.

Tarsidin (2010) describes a scheme for optimal results, the scheme can efficiently push *mudharib* to make the effort or the best act and pressing problems of moral hazard. The main things that influence the profit-sharing scheme is the disclosure of customers true character, the number of the results expected by both parties, the level of effort the customer and reporting the results of the profit generated which will be shared between *shahibul maal* and *mudharib*. Jensen and Meckling (1976) in Muhammad (2008) describes the practice of modern finance, there are two ways to do fund owner (*shahibul maal*) to reduce the risk due to customer action (*mudharib*) adverse, namely (1) owners of capital supervision (monitoring) and (2) customers themselves make a limitation on actions (bonding). The second implication of this activity are: (1) customers can reduce the chance of irregularities so that the value of the company (projects) increased and (2) will bring that will affect the cost of reducing the value of the company / project. The second way in which the owners of capital (*shahibul maal*) is also consistent with the hadith of the Prophet that:

> *"Abbas bin Abdul Muthalib if handed treasure as mudaraba, he requires to mudharib order not sailed the seas and down the valley, and does not buy cattle. If the requirements are violated, he (mudharib) must bear the risk. When the requirements set by Abbas heard the Prophet Muhammad, he justifies".* (HR Thabrani from Ibn Abbas).

Table 1. Moral Hazard behaviour model of customers in Islamic Banking Perspective Asymmetric Information Theory

Moral Hazard Behaviour	**Explanation**
Not responsible	One of the moral hazard behaviors that occur is that the customer takes financing and does not fulfill his obligation to pay. This behavior has consequences for the customer to be blacklisted by Bank Indonesia, and ultimately the customer will find it difficult to obtain financing in all banks. One of the driving factors that make a customer engage in moral hazard behavior is the encouragement of the consumer's behavior .
Mark-up	Cost manipulation behavior occurs mainly in *Mudharabah* financing. The customer manipulates the prices of raw materials used in the project. Business partners do mark-ups to increase profits.
Fraud	Fraud that occurs in Islamic banks for example is transferring customer responsibility by using the KPR (People's housing credit) facility to someone else who is actually fictitious or non-existent, so that the financing is not paid by the customer. this is a moral hazard that does occur because of the intentions of these customers. The existence of moral hazard behavior by the customer will basically make the bank be more careful in channeling its financing, because the risk faced by the bank will be higher.

4.2 Mitigation of Customer's Moral Hazard Behavior

Moral hazard in banking can be divided into at least two levels, namely Moral hazard at the bank level and moral hazard at the customer level (Mulki, 2011). Moral hazard in banks occurs when Islamic banks as mudarib are not careful in channeling funds so that they have the potential to cause moral hazard on the side of the customer and cause losses.

Generally Moral hazard to customers occurs in financing products based on equity financing (*mudharabah* and *musyarakah*) or commonly known as profit loss sharing. *Mudharabah* contracts that do not require guarantees and also give full rights to *mudharib* to conduct business without the intervention of *shahibul maal* and the loss of the *shahibul maal* are borne resulting in this financing agreement being very vulnerable to moral hazard. Moral hazard in the economy is the actions of economic actors that cause harm to oneself or others. To justify whether an economic act is a moral hazard or not, it is necessary to learn the principles of Islamic transactions, which are forbidden or forbidden (Hariyanto in Mulki, 2011).

Moral hazard is a risk that will be faced by Islamic banking at this time, therefore mitigation is needed to reduce that risk. This mitigation is then divided into two stages as follows:

a. Pre-Contract Mitigation

Pre-contract mitigation is a preventive measure undertaken by an Islamic bank before a financing agreement is made between the customer and the Islamic banking. This action is an early warning attempt by an Islamic bank to assess prospective customers who will take profit-sharing financing.

Actions taken by Islamic banks are to analyze customer character, provide business eligibility requirements and require collateral. In conventional banking we know the term 5C + 7P, which is the principles of lending. Islamic banks also apply these principles, including Character, Capacity, Capital, Collateral, Condition of economic.

Examination and analysis related to the financial statements of customers who will take financing in Islamic banks is very important to reduce the risk of customers not being able to pay their obligations when or when due. Therefore, the analysis of financial statements must be done by Islamic banks first. Analysis that can be done by Islamic banks are Current Ratio, Debt equity, cash flow. In addition, there are other requirements such as no history of arrears, personal guarantee, and also fire insurance. It is also considered from a minimum of 2 years of operation and complete licensing.

Actually, regarding guarantees, in accordance with DSN-MUI Fatwa No. 07/DSN-MUI/IV/2000 concerning *muḍharabah* financing that in principle, in *muḍharabah* financing it is not permissible to ask for guarantees from *muḍharib*, but so that *muḍharib* does not commit irregularities, the LKS can ask guarantees from *muḍharib* or third parties. And the guarantee can only be disbursed if *muḍharib* is proven to have committed a violation of matters mutually agreed upon in the contract.

b. Post- Contract Mitigation

Post-contract mitigation is an effort to prevent moral hazard behavior of customers after the Bank provides financing to customers. Moral hazard is information asymmetry that occurs after the transaction is carried out, this gives the position to the Islamic bank to be in the position of receiving risk from the business carried out by the borrower. Periodic supervision is one step that is often done by Islamic banking, such as regular visits at least 1 year 2 times.

The first goal is controlling, controlling the customer, whether the financing distributed is appropriate or not. The second stage is early warning, detecting what is likely to happen early. Supervision is a very important thing carried out by Islamic banks, to establish communication with customers, so that Islamic banks better understand the customer's business and can detect it early if the customer deviant behavior. In addition to strict supervision, it also requires customers to report their financial statements.

This is done by Islamic banks because profit-based financing is financing that is vulnerable to report manipulation so that Islamic banks require it. Mitigation steps that can be taken by Islamic banks is the determination of cost standards (Hadi, 2011). The standard costs function so that customers do not make mark-ups related to the prices of raw materials and business operating costs.

Diamond and Verrecchia stated that information asymmetry could be reduced if the company implemented a broad financial reporting policy and was instead disclosed by Bloomfield and Wilks that the more comprehensive the completeness of financial reporting, the smaller the information asymmetry.

5. Conclusion

As a conclusion that is in the contract of financing much-needed information asymmetry between the owners of capital (*shahibul mall*) and the manager of the capital (*mudharib*) in order to achieve common interests. One of the indicators that lead to moral hazard is due to asymmetric information or dissimilarity of information provided, and influential in the contract of financing.

Besides, asymmetric information is one of the causes of moral hazard which is not only of the moral hazard *mudharib* doing rather than the mall shahibul can perform this moral deviation. Capital owners (*shahibul mal*) may provide information that was not clearly associated with the development of the company in this case the financial institution, if the integrity of the institution in the eyes of public or not. Thus, the need for mitigation of the moral hazard behavior of customers by mitigating pre-contract and post-contract mitigation

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