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Islamic rural bank mission drift: Equity financing vs debt-based financing

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Abstract

Purpose – This study aims to compare the depth of outreach, financial performance, and trade-off between the depth of outreach and financial performance (mission drift) between equity financing and debt-based financing in Indonesian Islamic Rural Banks.

Methodology – We compare the depth of outreach and financial performance using descriptive statistics and explore mission drift comparisons using OLS time series.

Findings – The depth of the outreach comparison shows that debt-based financing performs better. However, equity financing outperforms financial performance. The regression results show mission drift in *Musharaka* and Multiservice financing, indicating that both sides have mission drift. However, there is no mission drift in *Murabaha* financing, which constitutes the majority of financing in Indonesian Islamic Rural Banks. *Murabaha* financing synchronously demonstrates excellent depth of outreach and financial performance.

Implications – Islamic Rural Banks in Indonesia need product innovation in equity financing to obtain a better depth of outreach and avoid mission drift. The simplicity of the practice in *Murabaha* can be a reference for product innovation in Islamic Rural Banks, while the government can support Indonesian Islamic Rural Banks' product innovation by providing appropriate regulations.

Originality – This study seeks to fill the comparison gap between mission drifts in Indonesian Islamic rural bank financing. There is a limitation in studies of Islamic rural bank financing mission drifts in Indonesia since the comparison of mission drift deals only with Islamic microfinance at a global level.

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Introduction

The Indonesian government passed Law No. 7 in 1992, which legalizes rural banks in Indonesia. This law imposes various restrictions on rural banks (capital size, location, and type of business). This allows rural banks to focus more on providing services to rural communities, low-income communities, and micro and small businesses. These rural banks aim to modernize the village community and help free small communities from moneylenders who charge very high interests (Robinson, 2001).

The Islamic rural banks in Indonesia were founded in the same spirit of empowering the MSME sector. Islamic Sharia values have been applied to Islamic rural bank practices in line with the

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aspirations of predominantly Muslim Indonesians. Islamic values are expected to embody justice, fairness and ethics (Khan, 2010). In other words, Islamic rural banks have two missions. The first is the government's mission to modernize rural communities and help liberate small communities. The second mission is compliance with Sharia, in which there are values of justice, morals, and ethics.

However, Islamic rural banks' goals can change over time (i.e., mission drift). From its original purpose of supporting low-income rural communities and micro-enterprises, it has moved to commercialization. With commercialization, Islamic rural banks will likely focus on capital owners' profitability and financial sustainability concerns.

However, problems with non-Sharia Islamic financial practices have begun to surface (Khan, 2010). *Murabaha* syndrome has provoked criticism of this debt-based practice (Miah & Suzuki, 2020). This phenomenon is believed to have made Islamic banking more similar to traditional banking. In contrast, *Mudaraba* and *Musharaka* (profit-sharing basis) financing is seen as an expression of the values of justice and unity (Fatwa of the National Sharia Board – Indonesian Ulama Council (DSN MUI), No. 8). Therefore, there seems to be an assumption that the more profit-sharing funds under Islamic financial institutions (IFI), the more the IFI will be seen as applying Sharia principles. Conversely, if trade-based financing predominates, IFI Sharia compliance becomes questionable (Chong & Liu, 2009).

This paper does not intend to continue the debate on equity financing and debt-based financing from the Sharia side, but it aims to reveal the other side, namely from the mission drift side (which represents the value of partiality and *Maslaha*). This study aims to compare mission drift between debt-based financing and equity financing in Islamic rural banks in Indonesia. Islamic rural banks are chosen because they are legal and well-regulated Islamic Microfinance Institutions in Indonesia. In addition, the accessibility and availability of data are relatively easy compared with other Islamic Microfinance Institutions.

Much research has been conducted on mission drift, including Hermes and Lensink (2011) and Xu et al. (2016), who state that mission drift occurs in Microfinance Institution (MFI) practice, while Gonzalez and Rosenberg (2006), Mersland and Strøm (2010), and Quayes (2012) state that mission drift does not occur in MFIs. Essentially, mission drift occurs when there is a trade-off between social and financial performance, where the depth of outreach is an essential proxy for measuring social performance (Xu et al., 2016).

Quantitative studies on mission drift in MFI have attracted various research interests. Some focus on case studies examining mission drift at specific MFIs (Beisland & Mersland, 2017). Some discuss it more broadly, both at the national level in Bangladesh (Mia & Lee, 2017) and Bolivia (Rhyne & Otero, 2006), as well as at the regional level (Christen, 2001; Olivares-Polanco, 2005) in Latin America. Research at the global level is more dominant (Cull et al., 2007; Hermes & Lensink, 2011; Kar, 2013; Mersland & Strøm, 2010; Quayes, 2012; Serrano-cinca & Gutierrez-Nieto, 2014; Xu et al., 2016) that is generally uses data from the Microfinance Information Exchange (MIX Market) database.

Moreover, the literature must be more extensive when focusing on quantitative studies of the mission drift of Islamic Microfinance Institutions. We have found several studies comparing the mission drift of Islamic Microfinance Institutions, namely Ahmad et al. (2020), Berguiga et al. (2020), Fan et al. (2019), Tamanni and Haji Besar (2019), and Widiarto and Emrouznejad (2015), which use the MIX Market dataset with panel data from various countries. All the studies mentioned above compared mission drift between conventional MFIs and Islamic Microfinance Institutions. At the same time, we attempted to find papers specifically discussing mission drift in Islamic Microfinance Institutions by comparing financing contracts.

Meanwhile, if we focus more on research on MFIs' mission drift of MFIs in Indonesia, the results will be even more difficult. The maximum result is in Charitonenko and Afwan (2003), entitled 'Commercialization of Indonesian MFIs,' with the research object being the BRI Unit Kupedes. Utilize descriptive data of Loan Sizes Compared to GDP per capita for 1990 – 2001. This study states that there is no mission drift in the commercialization of BRI Kupedes. As far as the literature has read, research related to outreach or mission drift is difficult to find. Most research on Islamic rural banks tends to examine it from a financial performance perspective, such as Fauzi (2018), Nugrohowati and Bimo (2019), and Sudarsono et al. (2021).

Based on the above description, this study seeks to contribute to the literature in three ways. First, we evaluate the mission drift of Islamic financing in each contract (equity financing and debt-based financing); second, we evaluate the depth of outreach of each financing contract in Islamic rural banks in Indonesia; and third, we evaluate the equivalent yield of each financing on Islamic rural banks in Indonesia. The problem formulation used in this study is as follows. The first question is what is the depth of outreach (social performance) of Islamic rural banks for debt-based financing compared to equity financing? Second, what is the financial performance of Islamic rural banks in terms of debt-based financing compared to equity financing? The third question is whether there is a mission drift in both Islamic rural banks' debt-based and equity financing.

Literature Review

The research topic" Mission Drift' is a developing theme and is in high demand by researchers, as evidenced by numerous studies on this subject (Gutiérrez-Nieto & Serrano-Cinca, 2019; Hermes & Hudon, 2018). Mission drift occurs when there is a trade-off between the depth of outreach and financial performance (Xu et al., 2016). The debate on mission drift began with the goal of MFIs addressing poverty alleviation; however, issues related to financial performance and sustainability have surfaced, and moving MFIs from their primary goal of poverty alleviation to fiscal policy goals has led to a debate as to whether to prioritize performance and sustainability (Kar, 2013). The shift in the MFI's primary goal from poverty reduction to financial performance is mission drift (Hermes & Lensink, 2011).

Discussion on Mission Drift

Addressing the risk of mission drift has been high on the industry agenda since PRODEM (a Bolivian non-government MFI) was commercialized and transformed into a shareholder-owned Banco Sol in 1992 (Mersland & Strøm, 2010; Rhyne, 1998). Events such as the initial public offering of Banco Compartamos in Mexico, which cost a handful of people a fortune of USD 450 million, have also added fire to the debate on mission drift (Gonzalez & Rosenberg, 2006).

Within policy circles, there has been extensive debate on this issue between welfarists, who spread the dominance of the depth of outreach objectives, and institutionalists, who highlight the importance of efficiency and sustainability in ensuring the long-term viability of the MFI (Hermes & Lensink, 2011; Kar, 2013). Both camps provided evidence to support these views. Recently, however, both sides have moved toward agreement, concluding that under certain conditions, the sustainability and depth of outreach may be compatible (Hermes & Hudon, 2018; Morduch, 2005).

The next question is whether MFI can experience mission drift. Smaller loans require higher transaction costs per unit, suggesting that going deeper into larger loans can have adverse effects (Quayes, 2012; Reichert, 2018; Xu et al., 2016). This represents a compromise between the depth of the outreach and sustainability. Cull et al. (2009) further prove that trade-offs between the depth of reach and commercialization are possible. However, Hermes and Hudon (2018) and Rhyne (1998) suggest that more commercial microfinance industries better serve the poorest members of society because their profit motive makes them more efficient and more willing to find new markets for their lending products. The changes brought about by the introduction of FinTech have also increased the efficiency of MFIs as the cost of public involvement has decreased (Hartarska & Nadolnyak, 2007). This implies that a shift in mission may occur if the MFI seeks higher returns, but this effect can be counteracted if the MFI can improve its cost efficiency (Mersland & Strøm, 2010).

In contrast to the widespread mission drift research on microfinance in general, mission drift literature on Islamic microfinance still needs to be developed. Ahmad et al. (2020), Berguiga et al. (2020), Fan et al. (2019), Tamanni and Haji Besar (2019), and Widiarto and Emrouznejad (2015) compared outreach performance between MFIs and non-Sharia MFIs globally. Most of their research results show that mission drift does not occur in LKMS, and the outreach performance of LKMS is relatively better than that of conventional microfinance. Different results are only shown by Berguiga et al. (2020), who show mission drift in Islamic microfinance.

Mission drift studies on Islamic rural banks in Indonesia are yet to be conducted. Our literature search revealed only two similar studies (Mulyaningsih et al., 2016; Wasiaturrahma et al., 2020). These two studies investigated Islamic microfinance in Indonesia, but did not focus on Islamic rural banks. The results of the research by Mulyaningsih et al. (2016) show indications of mission drift in Islamic microfinance because there is a trade-off between financial performance and social performance. Furthermore, Wasiaturrahma et al. (2020) also provide indications of trade-offs between assets and outreach in Islamic microfinance in Indonesia.

Debt-based and Equity Financing

Two types of transactions (contracts) are commonly practiced in Islamic financial theory: 1) social contracts (*Tabarru'*) and 2) commercial contracts (*Tijari*) (Antonio, 2011). The *Tijari* Group includes debt-based and equity financing. Debt-based financing usually uses commercial contracts, such as the *Murabaha*, *Salam*, *Istisna*, and *Ijara* contracts. Equity financing typically uses profit-sharing arrangements such as *Mudaraba* and *Musharaka*.

The Sharia Banking Statistics of Indonesian Financial Services Authority report (SPS OJK) uses eight contracts used by Islamic rural banks, one of which is the *Tabarru* contract and seven are *Tijari* contracts. One such *Tabarru'* contract is the *Qardh* contract, a loan contract in which the lender does not ask for a repayment. The seven contracts used by *Tijari* included two profit-sharing contracts (equity financing) and five sales contracts (debt-based financing).

The profit-sharing contracts (equity financing) used were *Mudaraba* and *Musharaka*. Various studies state that these two types of contracts represent a significant difference between Islamic and conventional Financial Institutions. *Mudaraba* and *Musharaka* are considered unique identities of LKS, whose ethical and moral values are prominent (Khan, 2010). *Mudaraba* is a profit-sharing contract in which one party becomes the funder (*Shahibul-maal*) and the other becomes an employee (*Mudarib*). *Musharaka* is a profit-sharing contract in which all parties contribute funds to one or all parties as employees (Antonio, 2011).

The SPS report lists five debt-based financing types on its Debt Financing page: *Murabaha*, *Salam*, *Istisna*, *Ijara*, and Multiservice. A *Murabaha* is a sales contract in which the cost and profit are known and mutually agreed upon between the buyer and seller. *Salam* and *Istisna* contracts are sales contracts in which purchase money is first given and the goods are delivered later. The difference between *Salam* and *Istisna* is that all purchase funds are given up front in the Salam contract, whereas in the *Istisna* contract, money is given in stages (Antonio, 2011). The next is the *Ijara* contract. This is known as buying and selling services and is commonly known as leasing. The final financing is Multiservice Financing, which is related to the National Sharia Board – Indonesian Ulama Council Fatwa Number 44 (Sam et al., 2014) using *Ijara* or *Kafala* contracts.

This debt-based contract has received criticism in various circles. Debt-based contracts, especially *Murabaha*, are the most widely used contracts in Islamic Banking practice (Miah & Suzuki, 2020). Criticisms of the debt-based contract include 1) *Wakala's* practices in purchasing goods, 2) margins believed to be excessive, and 3) believed to be similar or identical to traditional lending. Some believe that the prevalence of this *Murabaha* practice has made it less attractive to Muslim communities. Based on the common *Murabaha* practice, the public concludes that there is no difference between Islamic and conventional banking (Chong & Liu, 2009). Almost the same happened with multiservice financing.

Given that *Murabaha* is the most frequently used financing for Islamic rural banks in Indonesia (Otoritas Jasa Keuangan, 2020), the finding of indications of mission drift in *Murabaha* confirms the majority of criticisms of this financing. On the other hand, if there is no mission drift in *Murabaha* financing, then these results will support research by Ahmad et al. (2020), Fan et al. (2019), Tamanni and Haji Besar (2019), and Widiarto and Emrouznejad (2015).

Research Method

The methods used in mission drift research vary from study to study. Quayes (2012) used two-stage least squares, Kar (2013) used the 2SLS error components method, Serrano-cinca and Gutierrez-Nieto (2014) used the logistic regression method, and Hermes and Lensink (2011) used the pooled

regression method. However, most of the research uses panel data because the data used are in the form of panel data, namely data from various MFIs spanning several years. The following are some studies using panel data: panel data estimation (Cull et al., 2007), static and dynamic panel data estimation methods (Mia and Lee (2017), panel models estimated using fixed effects and random effects (Xu et al. (2016), and the GMM Estimator method (Mersland and Strøm (2010).

The methodology used in this study is time-series OLS. This method was used because it suits the retrieved and used data. The data obtained and used were time series from January 2010 to February 2020.

Table 1. Variable Description

Variable	**Description**
Average loan per borrower each financing in million rupiah (total value of outstanding each financing divided by the number of each financing client)	
ALB*Mudaraba*	Average loan per borrower *Mudaraba* financing
ALB*Musharaka*	Average loan per borrower *Musharaka* financing
ALB*Murabaha*	Average loan per borrower *Murabaha* financing
ALB*Istisna*	Average loan per borrower *Istisna* financing
ALB*Ijara*	Average loan per borrower *Ijara* financing
ALB*Qardh*	Average loan per borrower *Qardh* financing
ALBMultiservice	Average loan per borrower *Multiservice* financing
Equivalent of yield rate (IH) each financing	
IH*Mudaraba*	Equivalent of yield rate *Mudaraba* financing
IH*Musharaka*	Equivalent of yield rate *Musharaka* financing
IH*Murabaha*	Equivalent of yield rate *Murabaha* financing
IH*Istisna*	Equivalent of yield rate *Istisna* financing
IH*Ijara*	Equivalent of yield rate *Ijara* financing
IHMultiservice	Equivalent of yield rate Multiservice financing
Financial performance	
CAR	Capital adequaci ratio
ROA	Return on asset
ROE	Return on equity
NPF	Non performing financing
FDR	Finance to deposit ratio
BOPO	The ratio of Operational Expenses to Operational Revenue
Yield	Yield on gross portfolio. Financial revenue from financing portfolio divided by gross financing portfolio
WOFF	Write off portfolio. total value of financing write-off divided by gross financing portfolio
Avprofit	Average profit per borrower (total profit divided by the number of financing clients)
Avoc	Average operational cost per borrower (total cost divided by the number of financing clients)

Variable

As previously explained, mission drift occurs when there is a trade-off between depth of outreach and financial performance. Almost all previous studies by Cull et al. (2007), Hermes and Lensink (2011), Kar (2013), Mersland and Strøm (2010), Mia and Lee (2017), Quayes (2012), and Xu et al. (2016) use the Average Loan Balance (ALB) Per Borrower as a proxy for the depth of outreach. They then modified it by dividing (ALB) Per Borrower by GNP per capita to eliminate bias in currency values and macroeconomic conditions between countries.

Financial performance indicators are relatively numerous and diverse, as most financial performance indicators are independent variables, and each study uses multiple financial performance variables. The operational self-sustainability (OSS) variable is the most commonly used measure of an MFI's financial performance. Several studies have used this variable, including Cull et al. (2007), Kar (2013), Mia and Lee (2017), Quayes (2012), and Xu et al. (2016). The OSS is calculated by dividing operating income by the sum of operating expenses, financial expenses, and loan loss provisions.

In addition to OSS, various indicators have been employed in the extant literature to assess financial performance. Return on Assets (ROA) has been utilized in studies conducted by Kar (2013), Mia and Lee (2017), and Quayes (2012). Return on Equity (ROE) has been a focal metric in the research conducted by Xu et al. (2016), while Portfolio Yield (PY) and Total Assets were considered in the investigation by Serrano-cinca and Gutierrez-Nieto (2014), and Average Profit was employed in the study by Mersland and Strøm (2010).

Complementing the examination of financial performance from an income perspective, several scholars have delved into operational efficiency using diverse proxies. Mersland and Strøm (2010) gauged efficiency using the Average Operational Cost Loans per Staff Ratio, Serrano-cinca & Gutierrez-Nieto (2014) assessed efficiency through Operating Expenses, and Hermes and Lensink (2011) specifically focused on using efficiency as a proxy for financial performance.

We use the following regression model to determine the differences in the effect of financial performance on the depth of outreach for each financing type (both debt-based and equity financing).

$$\text{ALB } Y_t = \beta_{1t} + \beta_2 \text{DIH } Y_t + \beta_3 CAR_t + \beta_4 ROA_t + \beta_5 ROE_t + \beta_6 NPF_t + \beta_7 FDR_t + \beta_8 DBOPO_t + \beta_9 YIELD_t + \beta_3 WOFF_t + \beta_3 DAVPROFIT_t + \beta_3 AVOC_t + \mu_t \quad (1)$$

For each independent variable, we use ALB per borrower as a proxy for depth of outreach. This is obtained by dividing the total financing amount of each financing type by the number of borrowers in each type of financing. In the dependent variable, the financial performance of each financing type is represented by the equivalent return amount, along with the overall financial performance of Islamic rural banks. Islamic rural banks' financial performance, which is used as an independent variable, includes financial performance, which is used as an independent variable include: 1). Equivalent rate of return for financing, ROA, ROE, YIELD, and AVPROFIT as proxies for profitability; and 2). BOPO and AVOC are proxies for efficiency, 3). CAR is a proxy for capital structure, 4). NPF and WOFF are proxies for troubled financing, and 5). FDR as a proxy for liquidity.

There were three stages to ensure that our regression model yielded the best results. First, in modeling and selecting variables, we refer to reputable studies, such as Cull et al. (2007), Mersland and Strøm (2010), Quayes (2012), and Reichert (2018). Next, we performed data transformations to achieve linearity, normality, and variance stationarity (IP et al., 2018). Third, we provide a unit root test (Dickey-Fuller test) to determine whether the data are stationary and avoid spurious results (Gujarati, 2014).

Mission drift occurs when one of the independent variables has a positive and significant effect on the ALB per borrower for each contract (as a proxy for the depth of outreach). A positive and significant correlation exists between the independent variable (financial performance) and ALB per borrower, suggesting that financial performance improves as the ALB per borrower increases. An increase in ALB per borrower means a decrease in social performance because Islamic rural banks serve wealthier people than those who are poorer (Quayes, 2012). In other words, there is a trade-off between financial and social performance, where financial performance improves on the one hand but serves wealthier people on the other. This trade-off between financial performance and depth of outreach is an indication of mission drift in microfinance (Ahmad et al., 2020; Cull et al., 2007; Fan et al., 2019; Hermes & Hudon, 2018; Hermes & Lensink, 2011; Kar, 2013; Mersland & Strøm, 2010; Quayes, 2012).

If the positive and significant effect is one of the proxies for profitability, it can be concluded that mission drift is real. Conversely, if other proxies (efficiency, liquidity, capital structure, and non-performing loans) are positively and significantly associated, we conclude that mission drift is indicated. If the regression results show no significant association or negative and significant results for the proxies for profitability, it can be concluded that there is no mission drift (Berguiga et al., 2020). The negative and significant results show that both outreach and financial performance depth can be achieved simultaneously without compromising each other (Reichert, 2018).

Data

This study uses data from the Financial Services Authority (OJK) website, the government's official website that publishes routine banking financial reports in Indonesia. The data source is the

monthly report "Sharia Banking Statistics," which provides complete data regarding the required variables. From this report, 122 observational data points were collected from January 2010 to February 2020. Each data point is the sum of all Islamic rural bank data for each month (not the individual Islamic rural bank data).

Table 2. Descriptive Statistics of the Variables

Variable	Obs	Mean	Std. Dev.	Min	Max
Average loan per borrower for each financing (million IDR)					
ALB*Mudaraba*	121	77,898	34,449	21,598	149,958
ALB*Musharaka*	121	107,338	46,308	26,247	173,657
ALB*Murabaha*	121	20,788	4,902	12,118	27,534
ALB*Istisna*	121	79,500	78,678	28,670	291,472
ALB*Ijara*	121	0,717	0,380	0,227	1,661
ALB*Qardh*	121	205,770	109,979	53,607	428,995
ALBMultiservice	121	18,341	7,914	8,690	32,043
Yield Proportion (IH) each financing					
IH*Mudaraba*	121	17,824	1,733	14,730	23,520
IH*Musharaka*	121	19,795	2,111	14,180	23,790
IH*Murabaha*	121	18,653	0,841	17,460	23,190
IH*Istisna*	121	9,382	2,942	7,110	20,600
IH*Ijara*	121	10,977	7,674	0,050	27,240
IHMultiservice	83	15,810	2,893	13,050	23,380
Financial Ratios					
CAR	121	22,462	3,820	14,540	33,250
ROA	121	2,443	0,679	0,080	3,970
ROE	121	16,561	4,763	3,550	29,210
NPF	121	8,147	2,070	3,010	11,800
FDR	121	120,707	10,218	91,500	139,960
BOPO	121	82,883	4,901	71,760	93,500
Yield	121	0,114	0,061	0,018	0,235
WOFF	121	0,020	0,003	0,014	0,027
Average profit and average operational cost per borrower					
profit	121	0,307	0,173	0,027	0,732
avoc	121	1,298	0,782	0,002	2,933

Source: Sharia Banking Statistics of Indonesian Financial Services Authority (SPS OJK) 2010-2020

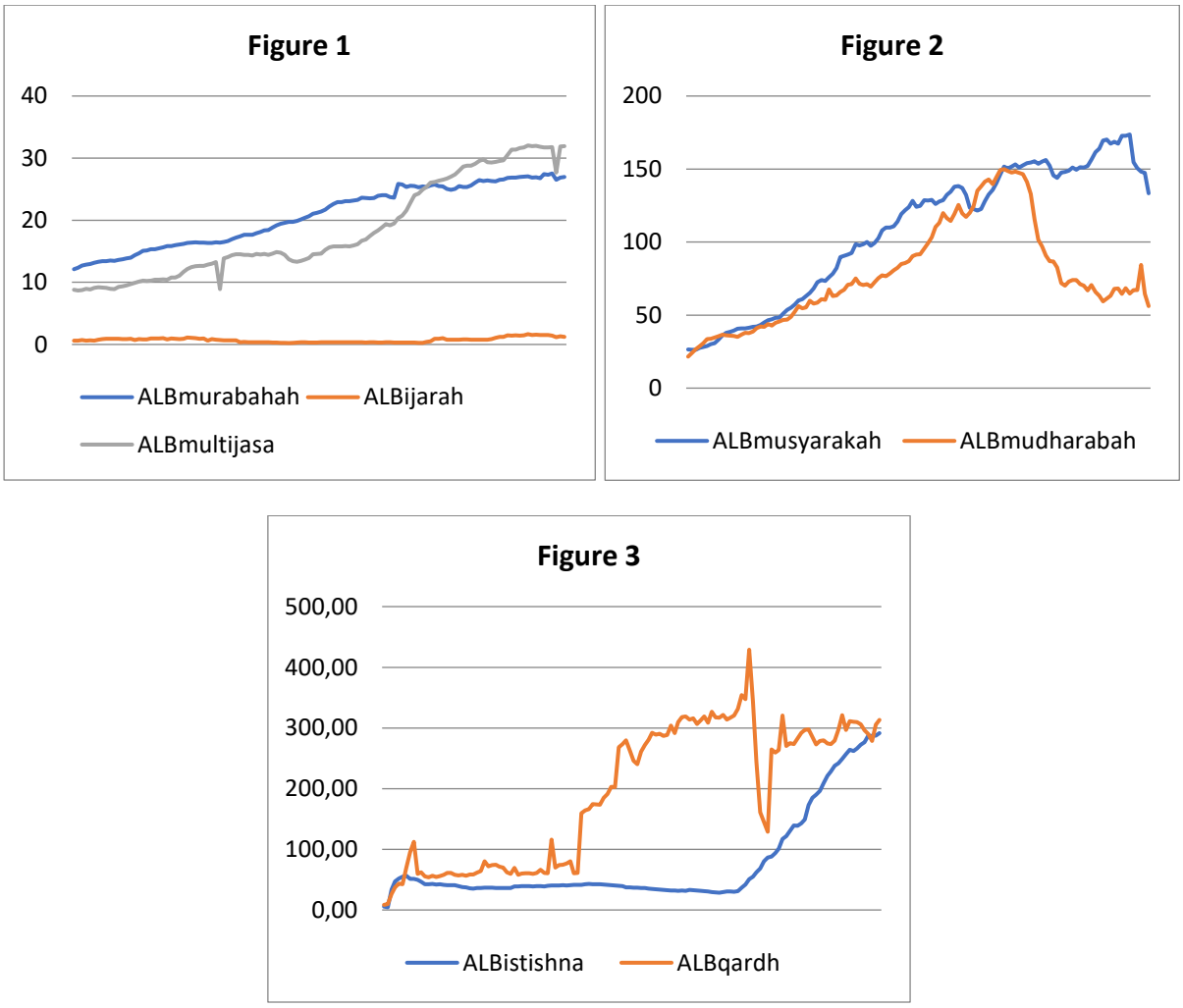
We have yet to consider data through the end of 2020, 2021, and 2022, as we only want to observe the progress of the data under normal circumstances. The April 2019 period began imposing social restrictions, which impacted national and global economic crises. We assume that the Covid period is maximized if we use panel data instead of the currently available data-only time series.

A total of 218 observations were recorded between January 2003 and February 2020. However, upon checking monthly data availability, we found that only the data from January 2010 to February 2020 were complete and consistent with data availability. However, data from January 2003 to December 2009 are not available on a monthly basis; some are available on a quarterly basis, and some are available on a semester and year basis. In addition to being temporally incomplete, values for some variables were unavailable; therefore, we used only relatively complete data from January 2010 to February 2020.

Results and Discussion

Islamic Rural Banks Depth of Outreach (Social Performance), Debt-based Vs Equity Financing

Descriptive statistics show that the average loan balance (ALB) per borrower (a variable used as a proxy for depth of outreach) increases year on year. This increasing trend also applies to ALB per borrower for each contract. This increasing trend can be seen graphically in ALB *Murabaha*, Multiservice, and *Musharaka* by borrowers, as shown in Figures 1 and 2.



Source: Sharia Banking Statistics of Indonesian Financial Services Authority (SPS OJK) 2010-2020

Figure 1, 2 & 3. ALB per-Borrower Each financing period 2010 to 2020

From Figure 1, we can see that ALB per Islamic rural bank borrower increased (from 10 million to 30 million). This also applies to *Murabaha* and multi-service financing. The ALB per borrower for *Murabaha* increased from 12 million at the beginning of 2010 to 27 million by the end of 2019. ALB per borrower for multiservice financing also increased slightly, starting at around 8 million in early 2010 and increasing to 32 million by the end of 2019. *Musharaka* financing shows a significantly higher range of increase (from approximately 20 million to approximately 173 million) (see Figure 2). The same thing as with ALB per borrower *Musharaka* also occurs with ALB per borrower *Mudaraba*. The Istisna ALB trend started showing an upward trend from 30 million in the beginning of 2017 to 291 million in February 2020 (see Figure 3).

Different from all the financing discussed, *Qardh* financing has the most diverse fluctuations. Surprisingly, *Qardhs* had the highest ALB per borrower, with a maximum of 428 million and average of 205 million. The highest value indicates that each *Qardh* financing customer receives this amount of financing on average. This highest value raises an interesting question: "Why is *Qardh* financing as a social financing, in the worst possible range?". *Qardh* is a social contract in which it is forbidden to profit from this financing practice (Antonio, 2011). Ideally, social facilities in microfinance are provided to poor people who are not provided to rich people (Hermes & Hudon, 2018; Quayes, 2012; Reichert, 2018). Further research is needed to answer the phenomenon of high ALB per borrower in *Qardh* financing in Islamic rural banks.

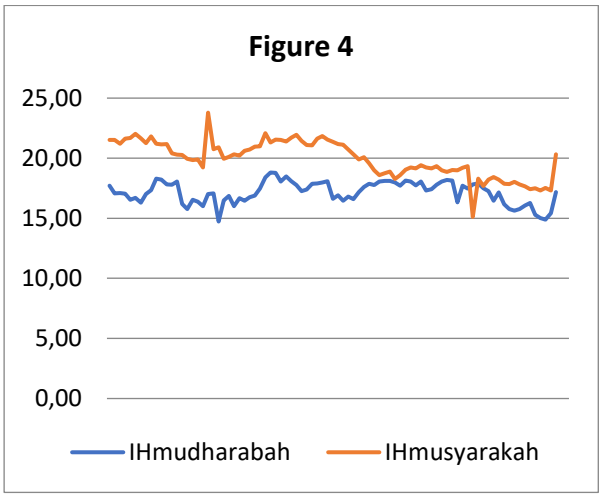
A comparison of the average ALB data for debt-based and equity financing shows that equity financing generally has a narrower outreach than debt-based financing. The average ALB of *Murabaha* and Multiservice as debt-based financing was low, at 20,788,000 and 18,341,000, respectively. Only *Istisna* had ALB relatively high of 79,5 billion. In equity-based financing, ALB

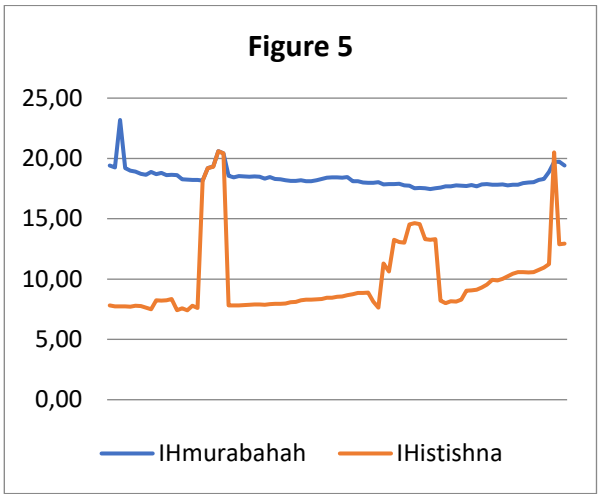
was 77.898 million for *Mudaraba* financing and 107.338 million for *Musharaka* financing. These data show that debt-based financing has a better depth of outreach than equity financing does. This dataset contradicts the notion of Khan (2010) and Miah and Suzuki (2020) that debt-based financing lacks justice, and instead demonstrates a bias towards assisting individuals with lower economic status.

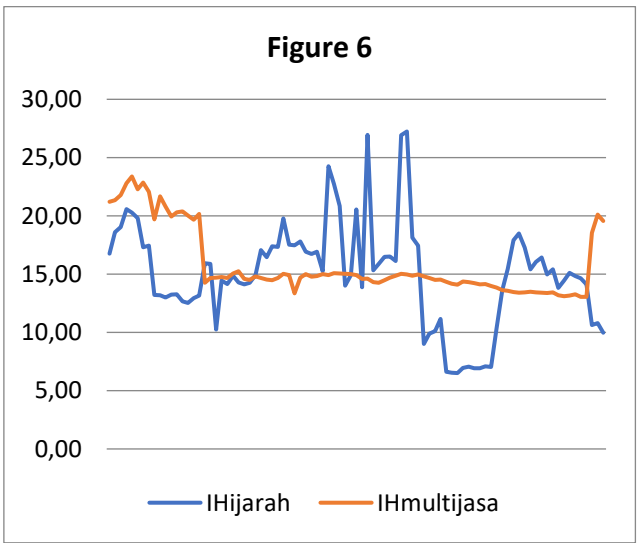
The depth of the outreach decreases as the number of ALBs per borrower increases. The declining depth of outreach has forced rural Islamic banks to focus more on wealthier customers (Quayes, 2012). However, a reduced range of depth of outreach only sometimes means that mission drift will occur. This mission drift occurs when decreasing the depth of outreach has a significant impact on financial performance (Cull et al., 2007; Hermes & Hudon, 2018; Hermes & Lensink, 2011; Kar, 2013; Mersland & Strøm, 2010; Quayes, 2012). Therefore, how the relationship between outreach depth and financial performance is significantly affected must be empirically proven.

Islamic Rural Banks Financial Performance, Debt-based Vs Equity Financing

Specific data on the financial performance of each contract/type of financing available in the Sharia Banking Statistical Report is equivalent to yield (IH). Meanwhile, the other financial performance variables are in their entirety and not in each contract. Thus, financial performance can only be compared by comparing the equivalent yield (IH).







Source: Sharia Banking Statistics of Indonesian Financial Services Authority (SPS OJK) 2010-2020

Figure 4, 5 & 6. Yield Equivalent of Each Financing Period January 2010 to February 2020

Figure 4 shows that the returns on equity financing, such as *Mudaraba* and *Musharaka*, are similar. Generally, IH *Musharaka* performs better than *Mudaraba* because IH *Musharaka* is always higher than IH *Mudaraba*. Figures 5 and 6 show that debt-based financing has different financial performances from one to another. The IH *Murabaha* was the most stable compared to the IH *Istisna* and IH Multiservice.

Therefore, which has better financial performance, debt-based financing, or equity financing? Based on the average yield, IH *Musharaka* ranked first (19.79%), IH *Mudaraba* ranked second (18.65%), and IH *Mudaraba* ranked third (17.82%). 4th place is IH Multiservice, with an average yield of 15.81%, 5th place is IH *Ijara* at 10.98%, and IH *Istisna* at 9.38%. Looking at the average rate of return, we conclude that the financial performance of equity financing is superior to that of debt-based financing.

Financial performance data substantiate the presumption regarding the predominant influence of Murabaha on financial outcomes, as suggested by Chong and Liu (2009), Khan (2010), and Miah and Suzuki (2020). By contrast, despite exhibiting superior financial performance, equity financing constitutes a comparatively minor share. This can be attributed to the primary consideration of safety and risk factors in equity financing decisions, as Fan et al. (2019) emphasize. Consequently, Islamic rural banks tend to prioritize funding to genuinely secure clients.

Islamic Rural Banks Mission Drift, Debt-based Vs. Equity Financing

Table 3. Indonesian Islamic Rural Banks Mission Drift Regression Results

Variable	*Mudaraba*	*Musharaka*	*Murabaha*	*Istisna*	*Ijara*	*Qardh*	Multiservice
Equivalent of yield	0,535	-0,137	-0,064	0,028	-0,006	-	0,057
	(0,01)	(-1,67)*	(-1,35)	(0,15)	(-1,45)	-	(0,51)
CAR	-1,053	*-0,300*	0,018	0,164	-0,002	0,157	0,164
	(3,26)***	(-0,72)	(0,86)	(0,61)	(-0,46)	(0,76)	(1,91)*
ROA	0,785	3,267	0,070	0,148	0,012	0,413	-0,839
	(0,36)	(2,33)**	(0,50)	(0,82)	(0,35)	(0,30)	(-1,68)
ROE	0,402	-0,381	-0,029	-0,083	-0,008	-0,634	-0,105
	(1,60)	(-1,61)	(-1,78)*	(-0,45)	(-1,17)	(-0,40)	(-1,33)
NPF	0,919	-0,043	-0,128	-0,101	-0,017	-0,238	0,309
	(-1,02)	(-0,08)	(-2,20)**	(-0,90)	(-0,79)	(-0,41)	(1,60)
FDR	0,230	-0,115	0,022	-0,002	0,006	-0,131	0,017
	(1,75)*	(-1,44)	(2,62)**	(-0,01)	(1,95)*	(-0,16)	(0,61)
BOPO	0,018	0,022	0,001	0,060	0,004	-0,658	-0,025
	(-0,14)	(-0,27)	(0,09)	(0,54)	(2,31)	(-0,77)	(-0,86)
Yield	-12,146	-0,907	-0,002	-0,002	-0,031	-0,966	0,421
	(-0,37)	(-0,46)	(-0,72)	(-0,52)	(-0,06)	(-0,46)	(3,79)***
WOFF	-0,733	0,214	0,309	0,358	0,343	0,179	0,333
	(-2,23)**	(-0,01)	(1,46)	(1,29)	(0,47)	(0,86)	(2,69)***
Avprofit	-0,198	-0,755	0,109	-0,272	-0,147	0,332	0,346
	(1,39)	(-0,07)	(1,19)	(-0,14)	(-0,52)	(0,37)	(0,96)
Avoc	0,607	0,154	-0,081	0,195	0,022	0,217	-0,388
	(2,04)**	(-1,03)	(-0,42)	(0,53)	(0,40)	(0,11)	(-5,05)***
Constant	0,274	0,955	0,128	0,207	0,007	0,224	0,218
	(-0,70)	(3,25)***	(5,12)***	(5,17)***	(-0,84)	0,900	(2,54)**
Obs	121	121	121	121	121	121	88
R squared	0,2114	0,117	0,1685	0,0342	0,1242	0,0303	0,4495
Prob > F	0,0047	0,0002	0,0342	0,9835	0,434	0,9676	0,0000

Based on the depth of outreach and financial performance data, there are indications of mission drift in *Musharaka* and *Mudaraba* financing. This assumption is made because both have a high average ALB per borrower with fairly good financial performance (Hermes & Hudon, 2018; Quayes, 2012). Meanwhile, *Istisna* financing has the lowest financial performance, so the suspicion of mission drift could be stronger. To confirm this assumption, we discuss the following regression estimation results.

The results in Table 3 show a tradeoff between the depth of outreach and financial performance for *Musharaka* Financing and Multiservice Financing. This trade-off between depth of outreach and financial performance indicated that the mission drift occurs in those financing (Cull et al., 2007; Hermes & Hudon, 2018; Hermes & Lensink, 2011; Kar, 2013; Mersland & Strøm, 2010; Quayes, 2012). Mission drift does not occur in *Istisna*, *Ijara*, or *Qardh* financing because there is no trade-off. *Mudaraba* financing indicates mission drift because there is a significant positive relationship between efficiency and the depth of outreach (Reichert, 2018). *Murabaha* provides the best financing, as it can maintain the depth of outreach while delivering good financial performance.

Mission Drift on Equity Financing

Mission drift on *Mudaraba*

Indications of mission drift in mudharaba financing can be clarified by AVOC (efficiency), which has a positive effect on ALB/borrowers of *Mudaraba* Financing. This positive effect shows that a 1% increase in AVOC (efficiency) results in a 0.607% increase in ALB/borrowers of *Mudaraba* Financing, with a significant estimated coefficient at the 5% level. Because an increase in ALB/Borrower of *Mudaraba* Financing means a decrease in the depth of outreach of *Mudaraba* financing, in other words, the estimation results show that there is a trade-off between efficiency and depth of outreach. Thus, if the efficiency increases by 1%, then the depth of the outreach will decrease by 0.607%.

Other financial performance variables that significantly influence ALB/borrowers' *Mudaraba* financing are CAR, FDR, and WOFF. The CAR and WOFF variables have a negative effect, while FDR has a positive effect. In more detail, the regression results show that a 1% increase in cars results in a decrease of -1.053 ALB/Borrowers of *Mudaraba* Financing, significant at the 1% confidence level. Next, a 1% increase in FDR will increase ALB/borrowers of *Mudaraba* Financing by 0.23%, which is significant at the 10% confidence level. Meanwhile, an increase in WOFF of 1% will reduce ALB per borrower of *Mudaraba* Financing by -0.733%, which is significant at the 5% confidence level.

In *Mudaraba* financing, there is a trade-off between the efficiency and depth of outreach, liquidity, and outreach. Meanwhile, debt write-off (WOFF) has a negative effect on ALB per Borrower *Mudaraba* Financing, which means that the higher the write-off of receivables, the lower the depth of outreach. The capital adequacy ratio also has a negative relationship with the ALB/borrowers of *Mudaraba* Financing, which means that the higher the capital adequacy ratio, the better the depth of outreach.

The presence of a trade-off between financial and social performance within the context of *Mudaraba* signifies potential deviations from the intended mission of equity financing. Islamic rural banks prioritize financial performance, focusing on serving the population's wealthier segment through *Mudaraba* financing. This observation contrasts the conventional understanding of justice associated with *Mudaraba*, as discussed by Miah and Suzuki (2020). Additionally, it contradicts the assumption put forth by Berguiga (2020) that the implementation of profit-loss sharing mechanisms can mitigate trade-offs and mission drift.

Mission Drift on *Musharaka*

The regression results for *Musharaka* financing conclusively show that increased financial performance positively impacts ALB for *Musharaka* financing, with an squared of 0.117, which is significant at the 1% confidence level. The t-test results show that every 1% increase in ROA causes the ALB for *Musharaka* financing to increase by 3.267%, which is significant at the 5% confidence level. In other words, these results show that every 1% change in profitability sacrifices the depth of outreach of *Musharaka* financing by 3.267%.

In contrast to the positive impact of ROA, Musharaka's yield equivalent of *Musharaka* exerts a negative influence on the ALB of *Musharaka* financing. Specifically, a 1% increase in dih*Musharaka* corresponds to a -1.67% decrease in ALB for Musharaka financing, achieving significance at the 10% confidence level. This suggests that optimizing both the return and the

depth of outreach in *Musharaka* financing may pose a challenge. It is noteworthy that despite the negative impact, the effect of the yield equivalent on ALB for *Musharaka* financing is relatively weak compared to ROA, considering both the coefficient magnitude and significance level. Consequently, it can be inferred that mission drift occurs in *Musharaka* financing.

The identification of a trade-off within *Musharaka* financing, along with *Mudaraba* financing, underscores the broader trend across all equity financing mechanisms, revealing a trade-off between financial performance and ALB per borrower. This trade-off in equity financing suggests mission drift, wherein Islamic rural banks seem inclined to prioritize financial performance, potentially overlooking the needs of economically disadvantaged individuals. This finding stands in stark contrast to the perspective presented by Berguiga (2020), who posits that an escalation in equity financing would mitigate the occurrence of trade-offs or mission drift in Islamic Microfinance.

Mission Drift on Debt-based Financing

Mission drift on *Murabaha*

There is no evidence of a trade-off between the depth of outreach and financial performance in the regression results for *Murabaha* financing because each estimation coefficient of ALB for *Murabaha* financing has a negative sign. The results of the ROE estimation for ALB in *Murabaha* financing show a statistically significant negative impact. Every 1% increase in ROE decreases the ALB for *Murabaha* financing by -0.029%, which is significant at the 10% confidence level. In other words, there is no mission drift in *Murabaha* financing because there is no trade-off between profitability and depth of outreach. This result is based on the opinion (Morduch, 2005) that the sustainability and depth of outreach may be compatible under certain conditions.

Conversely, the estimation results for the ALB per borrower about Non-Performing Financing (NPF) for *Murabaha* financing reveal a statistically significant negative impact, surpassing both the coefficients and significance levels observed for Return on Equity (ROE). Specifically, for every 1% increase in NPF, there is a -0.128% decline in ALB for *Murabaha* financing. This outcome attains significance at the 5% confidence level, indicating that outreach increases as the prevalence of non-performing financing increases. Given that *Murabaha* also holds the majority of Islamic rural bank financing, this outcome could occur if the reaction to an increase in NPF is a reduction in the financing cap.

Considering that *Murabaha* financing holds the most dominant share in Islamic rural banks, the positive performance results offer significant encouragement to their stakeholders. This outcome implies that a substantial portion of the financing provided by Islamic rural banks is less susceptible to mission drifts. In terms of financing volume, as of January 2020, *Murabaha* financing constitutes 74.67% of the total financing amount, amounting to 7,711,400 out of the overall loan portfolio of 10,327,603. In terms of the number of loan customers, *Murabaha* financing customers represent 78.06%, accounting for 291,276 of the total 373,152 financing customers.

The outcomes presented here stand in contrast to the various criticisms of *Murabaha* financing put forth by Chong and Liu (2009), Khan (2010), and Miah and Suzuki (2020). Islamic rural banks can attain commendable financial and social performance by utilizing *Murabaha* financing. These findings further indicate that the predominant use of *Murabaha* does not lead to mission drift; instead, it positively contributes to the sustained financial and social performance of Islamic rural banks. The prevalence of *Murabaha* financing, constituting the majority of funding for Islamic rural banks, exhibits no signs of mission drift, consistent with the findings of prior studies by Ahmad et al. (2020), Fan et al. (2019), and Widiarto and Emrouznejad (2015).

Mission drift on Multiservice

The Yield, WOFF, and CAR variables have a positive effect, but AVOC has a negative effect on ALB Multiservice financing. The multi-service financing ALB revenue estimation results show a statistically significant positive impact. For every 1% increase in yield, the ALB of multi-service financing increases by 0.421%. This result is significant at the 1% confidence level. This result

indicates a mission drift at Multiservice Financing because there is a trade-off between the yield on the gross portfolio and ALB.

Similar to the yield, the CAR variable also shows a positive and statistically significant impact. Every 1% increase in CAR increases the multiservice financing ALB by 0.164%, which is significant at the 10% confidence level. The AVOC variable had a negative and statistically significant impact. Every 1% increase in AVOC reduces the multiservice financing ALB by -0.388, which is significant at the 1% confidence level.

In multi-service financing, there is a trade-off between revenue and depth of outreach, capital adequacy ratio, and depth of outreach. Meanwhile, WOFF positively affects ALB per borrower for multi-service financing, which means that the higher the write-off of receivables, the higher the depth of outreach for multi-service financing. Efficiency also has a negative relationship with ALB per borrower for multi-service financing, which means that the higher the efficiency ratio, the better the depth of outreach. The conclusion is that mission drift occurs in multi-service financing because there is a trade-off between income and the depth of outreach.

The regression outcomes pertaining to multi-service financing suggest that criticisms of debt-based financing are likely to be accurate. In contrast to *Murabaha* financing, which has a more explicit designation, multi-service financing exhibits enhanced flexibility. This flexibility is purportedly leveraged to enhance the financial performance of Islamic rural banks, but regrettably benefits the wealthier segment. The act of serving the affluent to improve financial performance is indicative of mission drift, as noted in Ahmad et al. (2020), Hermes and Hudon (2018), and Quayes (2012).

Mission Drift on *Ijara* and *Istisna*

The regression outcomes for *Istisna* financing indicate an absence of mission drift, as the estimation results do not demonstrate statistical significance individually or collectively. Similar patterns are observed in the cases of *Ijara* and *Qardh* financing, where the regression results for these financing types do not exhibit statistical significance concerning the financial performance variables. These findings align with the conclusions drawn from *Murabaha* financing, suggesting that debt-based financing, as criticized by Chong and Liu (2009) and Miah and Suzuki (2020), may not be as adversely affected as previously thought.

Conclusion

The regression results show evidence of mission drift in *Musharaka*, *Mudharaba*, and Multiservice financing. There is no evidence of mission drift in *Istisna*, *Ijara*, or *Qardh* financing. However, *Murabaha* financing is the best performer as it can maintain outreach while offering excellent financial performance. Furthermore, descriptive statistics analysis shows that the depth of outreach in debt-based financing is better than that in equity financing. Meanwhile, the financial performance of equity financing is better than that of debt-based financing. This result makes the mission drift in debt-based financing lower than in equity financing.

The lower mission drift in debt-based financing is a finding that can refute critics, especially *Murabaha* financing. *Murabaha's* dominations do not necessarily reflect low values of justice and unity but rather demonstrate the simultaneous achievement of social and financial performance. Even so, practitioners and Islamic rural banks have another important task: to make equity financing free from the indications of mission drift. Product innovation in equity financing can make it easier to apply and less risky.

This study has some limitations, such as the use of national data instead of data from individual Islamic rural banks. The unavailability of ALB/borrower data for each Islamic rural bank is the main reason we prefer to use already available national data. Future research can examine how mission drift occurs in Islamic rural banks by using individual Islamic rural banks' data, so that it will be able to see other independent variables that influence it. Moreover, future research needs to continue on ALB/borrowers of *Qardh* financing, which indicates the worst depth of outreach but cannot be explained by our regression model. Further research also needs to add macroeconomic effects to determine whether external factors influence mission drift in Islamic rural banks in Indonesia.

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