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FINANCING PRODUCT DIVERSIFICATION STRATEGY AND ITS IMPLICATIONS FOR PROFIT-AND-LOSS SHARING FINANCING CREDIT RISK (MUDHARABAH AND MUSYARAKAH CONTRACTS)

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Abstract

This study investigates the effectiveness of product diversification in managing credit risk in profit-and-loss sharing (PLS) financing at Bank Sumut Syariah. While Islamic banking theoretically leverages diversification for risk mitigation, akin to Modern Portfolio Theory, this research reveals an "Organizational Readiness Paradox": quantitative diversification has failed to effectively curb persistently high PLS risk. Using a qualitative descriptive-exploratory single case study approach, data were collected through in-depth interviews with 59 informants, field observations, and portfolio data analysis (2013–2024). Findings show that PLS non-performing financing consistently accounts for over 50% of total NPF and significantly exceeds consolidated NPF. This stems from a strategic gap between policy and portfolio reality, internal capability weaknesses (Human Resources 45.8%, Systems 28.8%), and misaligned incentive systems that prioritize volume over quality. The paradox underscores that elevated PLS risk is not inherent to Sharia contracts but rather reflects a mismatch between organizational capability and risk-sharing complexity. The study emphasizes the critical role of governance, robust Management Information System Early Warning System infrastructure, and adaptive human capital for effective diversification strategies.

Keywords: credit risk; Islamic banking; NPF; organizational capability; product diversification

INTRODUCTION

Islamic banking in Indonesia has grown steadily over the past decade, with its share of national banking assets reaching 7.41% by June 2025 and total assets rising from Rp676.7 trillion (2021) to Rp924.9 trillion (February 2025) (OJK, 2025). Despite this growth, credit risk management remains a persistent challenge, commonly measured through Non-Performing Financing (NPF) (Angraini & Anindita, 2020). While industry-wide NPF has been pushed below 3% since 2021, Bank Sumut Syariah illustrates a sharper paradox: although the number of financing products nearly tripled between 2013 and 2024, and overall NPF fell from 16.62% to 5.87%, NPF on profit-and-loss sharing (PLS) contracts mudharabah and musyarakah remained persistently high, peaking at 40.09% in 2020 and still at 10.85% in 2024, consistently exceeding consolidated NPF. By 2024, outstanding NPF from PLS contracts reached Rp107.40 billion, or 62.4% of total NPF.

This gap between portfolio diversification theory (Markowitz, 1952) and empirical performance motivates this study, which analyzes: (a) how the financing diversification strategy is implemented; (b) its implications for PLS credit risk; (c) the factors sustaining high PLS risk despite diversification; and (d) strategies to improve diversification effectiveness at Bank Sumut Syariah.

LITERATURE REVIEW

Modern Portfolio Theory (Markowitz, 1952; Fabozzi et al., 2002) holds that spreading exposure across assets with imperfect correlation reduces aggregate risk. In Islamic banking, diversification extends beyond sector and customer segment to contract type murabahah, ijarah, mudharabah, and musyarakah each carrying distinct risk profiles (Ernawati, 2016). Normatively, PLS contracts embody maqāṣid al-sharīʿah principles of ḥifẓ al-māl and risk-sharing (taʿāwun) (Maghrebi, 2015). Operationally, however, PLS financing depends heavily on client business performance and is exposed to information asymmetry and moral hazard, both before contracting (adverse selection) and after disbursement (moral hazard), which raise monitoring costs relative to fixed-margin contracts such as murabahah (Nouman & Ullah, 2014; Sholihah & Fatwa, 2021).

Agency theory and transaction cost economics (Eisenhardt, 1989) further explain why PLS contracts are structurally risk-prone: banks (as principals) delegate operational control to clients (as agents/mudharib) under conditions of asymmetric information, generating high ex-ante and ex-post transaction costs (search, negotiation, monitoring, enforcement). Prior empirical studies confirm that PLS financing exhibits higher NPF than non-PLS financing (Effendi et al., 2017; Widarjono et al., 2020), while diversification generally reduces aggregate NPF when supported by adequate risk management systems (Haq & Darmawan, 2023; Widarjono & Rudatin, 2021). Diversification failure is commonly linked to "pseudo-diversification" (correlated risk exposure despite nominal variety), weak integration between diversification and risk management, and limited human resource competence (Prastiwi & Anik, 2020; Ascarya, 2009). This study addresses the gap concerning how these structural and organizational factors interact to sustain high PLS risk even amid active diversification.

METHOD

This study employs a qualitative descriptive-exploratory approach using a single intrinsic case study design (Yin, 1984; Creswell & Poth, 2017), selected because Bank Sumut Syariah's Sharia Business Unit (UUS) presents an information-rich, theoretically significant paradox. Data were collected from 59 key informants across eight organizational functionsm Sharia Business Unit, Financing, Risk Management, Credit Recovery, Sharia Supervisory Board, Internal Audit, Credit Review, and Business Units via in-depth interviews, field observations, and documentation (2013–2024 portfolio data), enabling source and method triangulation (Carter et al., 2014). Data were analyzed using Braun and Clarke's thematic analysis (Nowell et al., 2017), following six stages: familiarization, initial coding, theme searching, theme review, theme naming, and reporting, combining inductive and deductive coding for analytical rigor (Fereday & Muir-Cochrane, 2006).

RESULTS AND DISCUSSION

This section presents the results with clear descriptions. Results can be supplemented with tables, graphs (**Portfolio Composition and NPF Trends (2013–2024)** Between 2013 and 2024, Bank Sumut Syariah's financing portfolio grew from Rp1,761 billion to Rp2,930 billion, but its structure shifted markedly. PLS financing (mudharabah + musyarakah) fell from 51.44% of the portfolio in 2013 to 33.77% in 2024, while murabahah rose from 46.18% to 65.99% (Table 1)

Table 1. Portfolio Composition by Contract Type (Selected Years, % of Total)

Year	Mudharabah	Musyarakah	Murabahah	PLS Total
2013	5.68%	45.76%	46.18%	51.44%
2018	1.45%	39.60%	58.70%	41.05%
2020	1.34%	27.33%	71.31%	28.67%
2024	0.76%	33.01%	65.99%	33.77%

Source: Bank Sumut Syariah financial reports (processed), 2025

Despite this declining PLS share, PLS contracts remained the dominant driver of credit risk. Consolidated NPF fell steadily from 16.62% (2015) to 5.87% (2024), while PLS-specific NPF stayed persistently higher, spiking to 40.09% in 2020 and settling at 10.85% in 2024 a ratio consistently above 1.0 and as high as 2.83× consolidated NPF (Table 2).

Table 2. Consolidated NPF vs. PLS-Contract NPF (Selected Years)

Year	Consolidated NPF	PLS NPF	Ratio (PLS/Consolidated)
2013	8.09%	8.67%	1.07
2019	16.13%	35.98%	2.23
2020	14.17%	40.09%	2.83
2024	5.87%	10.85%	1.85

Source: Bank Sumut Syariah financial reports (processed), 2025

The Organizational Readiness Paradox

Synchronizing quantitative and qualitative findings reveals an "Organizational Readiness Paradox" across three layers. *Strategically*, formal policy explicitly targets strengthened PLS financing and risk-managed diversification, yet actual portfolio allocation moved in the opposite direction. *Functionally*, despite a documented risk mitigation framework (four-eyes principle, credit scoring, Sharia Supervisory Board oversight), PLS NPF consistently exceeded consolidated NPF, with some PLS working-capital products reaching 100% NPF indicating the existing control framework does not effectively penetrate PLS-specific risk complexity. *Perceptually and culturally*, interviews showed most business-line staff viewed diversification as "fairly successful" and PLS risk as "lower and controlled," contrasting sharply with the NPF data; only risk-management and credit-review staff held more critical views.

Root-cause analysis attributes 45.8% of high PLS risk to human resource weaknesses account officers acting as generalists with minimal specialization, thin training, and no structured peer-review mechanism and 28.8% to systems weaknesses, notably the absence of automated early-warning dashboards, leaving monitoring largely manual and reactive. Compounding this, field observation found reward systems tied solely to disbursement volume rather than portfolio quality, incentivizing quantity over prudence (Eisenhardt, 1989; Sholihah & Fatwa, 2021).

Managerial Implications

Addressing this paradox requires integrated action across three layers: (1) *Policy* redefining diversification goals from product quantity toward risk-management capability, considering specialized PLS business units, and realigning incentive systems toward portfolio quality; (2) *Organizational capability* building PLS-specialized analyst competence, developing an adaptive Management Information System/Early Warning System with real-time monitoring dashboards, and integrating digital SOPs into actual risk-analysis practice; and (3) *Operational practice* cultivating risk-aware culture, deepening credit analysis, and enforcing the four-eyes principle with structured, proactive monitoring.

CONCLUSION

This study finds that Bank Sumut Syariah exhibits an "Organizational Readiness Paradox": a formally robust framework of structure, policy, and stated diversification strategy coexists with a widening strategic gap (rising murabahah dominance despite policy favoring PLS), a functional gap (persistently higher PLS NPF despite an ostensibly comprehensive mitigation system), and a perception/incentive gap (optimism bias and volume-based rewards) rooted in human resource and systems weaknesses (45.8% and 28.8% of causal factors, respectively). The elevated risk of mudharabah and musyarakah financing is therefore not inherent to Sharia contracts themselves, but reflects a mismatch between organizational capability and the complexity of risk-sharing instruments. Sustainable improvement requires coordinated reform across policy, organizational capability, and operational practice — particularly PLS-specialized human capital, adaptive MIS-EWS infrastructure, and quality-based incentive realignment rather than diversification in product count alone.

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