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Implementation of Sharia Risk Management in Handling Problematic Musyarakah Financing at Baitul Maal Wat Tamwil (BMT)

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Abstract: This article analyzes the role of Baitul Mal Wat Tamwil (BMT) as a non-bank microfinance institution that operates based on sharia principles with a profit-sharing system, which aims to improve the economic welfare of small communities. BMT provides financing products with the Musyarakah principle to support the sustainability of community businesses, especially in the field of Micro, Small and Medium Enterprises (MSMEs). However, despite its significant benefits, BMT also faces various risks that can affect its smooth operations. These risks are related to uncertainties that can lead to unexpected losses such as delays in financing payments. Therefore, the implementation of effective risk management is essential to mitigate these potential losses. Risk management includes the steps of planning, organizing, implementing, and controlling the risks that may occur. The method used in this research is the distribution of questionnaires directly to BMT officers using SmartPLS to analyze the relationship between the application of sharia risk management in handling problematic financing in BMT.This article discusses the importance of implementing good risk management in BMT to ensure smooth operations and business sustainability in the midst of existing challenges. Through this approach, it is expected that BMT can continue to operate optimally in improving the welfare of the community based on sharia principles.

Keywords: sharia risk management; musyarakah financing; Baitul Maal Wa Tamwil (BMT); internal conflict of interest; non-performing loans; agency theory

1. Introduction

Baitul Mal Wat Tamwil (BMT) is a non-bank microfinance institution that operates based on sharia principles with a profit-sharing system. This institution was established by and for the community in a certain area or region, with the aim of developing productive and investment businesses in order to improve the economic welfare of small communities [1] according to Azyumardi Azra in his book Giving for All (2003: 236). Baitul Mal wat Tamwil (BMT) is an economic institution or non-banking Islamic financial institution that is informal in nature. Baitul Mal wat Tamwil (BMT) is an economic institution or non-banking Islamic financial institution that is informal in nature.

This institution is called informal because it was founded by self-help groups, so it is different from banking financial institutions and other formal financial institutions Soemitra [2]. In its operations, BMT offers financing based on sharia principles, one of which is carried out with a musyarakah contract. Musyarakah financing products are usually found in Islamic financial institution such as BMT, financing institutions, Islamic insurance, and other institutions. Thus, this musyarakah financing product has become one of the prima donnas for the community to support the sustainability of the business to be undertaken through sharia-based services, both in fund storage products and capital financing [3]. [4][4] state that the musyarakah contract has several important reasons to be used as an alternative in improving economic conditions. This agreement is able to replace usury practices that are not in accordance with sharia principles. In addition, the musyarakah contract prioritizes the principle of cooperation that does not solely seek one-sided benefits, but also contains elements of mutual assistance between partners. Furthermore, Islamic financial institutions that use this contract can improve the welfare of MSMEs and society in general.

However, in carrying out its functions, BMT is also faced with various risks that cannot be predicted in advance. Risk is the potential for an event or event that can cause losses to a company or business, and the event is unpredictable [5]. Risk is the potential for unwanted or unexpected negative consequences. In other words, risk is the ability to show uncertainty, where uncertainty itself is a condition that increases the likelihood of risk occurrence [6].

Therefore, it is important for BMT to have effective risk management. Risk management according to [7], if a risk cannot be avoided, then the organization needs to implement a risk control strategy. This control is carried out by considering two main aspects, namely the likelihood of occurrence (probability) and the level of impact (severity), with the aim of reducing the likelihood of occurrence, reducing the impact caused, or both at once. Risk is the impact of uncertainty on the achievement of goals. The impact of this uncertainty can be beneficial or detrimental. In other words, risk is the potential occurrence of situations or conditions that can hinder the achievement of goals and objectives for both organizations and individuals [8].

2. Results and Discussion

2.1. Validity Test

The results of the validity test of the variable questionnaire of the implementation pattern of sharia risk management in handling problematic musyarakah financing at BMT are as follows:

Table 1. Validity Test Results

	Compliance with SOP (X2)	Internal Conflict of Interest (Z)	Outstanding Interests (Y)	Risk Management Strategy (X1)	X1*Z1	X2*Z2
(X1)* (Z)					**1.776**	
(X2)* (Z)						**1.762**
X1.1				0.858		
X1.2				0.762		
X1.3				0.824		
X1.4				0.872		
X1.5				0.829		
X2.1	0.856					
X2.2	0.818					
X2.3	0.831					
Y1			0.874			
Y2			0.894			
Y3			0.814			
Y4			0.870			
Z1		0.950				
Z2		0.946				

Source: Processed primary data

Based on Table 1, it can be concluded that each indicator has met the convergent validity criteria with a value> 0.7, so that the data can be considered valid and meet the requirements of convergent validity. This shows that each indicator has strong convergent validity and is able to reflect the latent construct being assessed well. Indicators on the Risk Management Strategy variable (X1), Compliance with SOPs (X2), Non-Performing Loans (Y), and Internal Conflict of Interest (Z) all show outer loading values that are between 0.762 to 0.950. In addition, the outer loading values for the interaction variables, namely X1Z and X2Z, are 1.776 and 1.762, respectively, which indicates that the interaction between constructs is very strong.

Thus, all indicators in this study can be considered convergently valid and suitable for future structural model analysis. The convergent validity that has been met indicates that each construct has suitability and internal consistency in measuring the intended concept. This finding is in line with the results of research from Sari and Nugroho (2024), where all construct indicators show an outer loading value> 0.70 and an Average Variance Extracted (AVE) value> 0.50. This indicates the existence of strong convergent validity in measuring latent constructs. The study used Smart PLS 3.0 to analyze the data, and reinforced the conclusion that indicators that meet these criteria can be considered valid and reliable.

2.2. Average Variance Extracted (AVE) Test

Table 2. Test Average Variance Extracted Results

	Average Variance Extracted (AVE)	Criteria	Description
Compliance with SOP (X2)	0.697	>0,5	Valid
Internal Conflict of Interest (Z)	0.899	>0,5	Valid
Outstanding Interests (Y)	0.745	>0,5	Valid
Risk Management Strategy (X1)	0.689	>0,5	Valid
X1*Z1	1.000	>0,5	Valid
X2*Z2	1.000	>0,5	Valid

Source: Processed primary data

Based on Table 2, it can be concluded that each indicator has a value> 0.5, so that the data can be considered valid and meet the AVE (Average Variance Extracted) criteria. The AVE value for the structure of Adherence to SOPs is 0.697; Internal Conflict of Interest is at 0.899; Non-performing Loans is 0.745; Risk Management Strategy is recorded at 0.689; while the interaction of X1Z1 and X2Z2 is recorded at 1.000 each. These figures indicate that the variance explained by the hidden constructs for their indicators is greater than the variance caused by measurement error. Therefore, it can be concluded that all the constructs in this model are valid in terms of convergence and the tool is suitable to proceed to the model structure testing stage. This finding is in line with research conducted by Hendriani (2020), which also showed that the Average Variance Extracted value for the constructs in the Islamic finance model exceeded 0.50, indicating adequate convergent validity and supporting the quality of the measuring instrument in the study.

2.3. Reliability Test

Table 3. Test Reliability Results

	Cronbach's Alpha	Composite Reliability
Compliance with SOP (X2)	0.787	0.874
Internal Conflict of Interest (Z)	0.888	0.947
Outstanding Interests (Y)	0.889	0.921
Risk Management Strategy (X1)	0.889	0.917
X1*Z1	1.000	1.000
X2*Z2	1.000	1.000

Source: Processed primary data

Based on Table 3 shows Cronbach's Alpha and Composite Reliability> 0.7 indicating that the indicators in each variable are consistent. The Compliance with SOP (X2) construct gets a Cronbach's Alpha value of 0.787 and a Composite Reliability of 0.874. On the other hand, the Internal Conflict of Interest (Z) construct shows a very high level of reliability with a Cronbach's Alpha value of 0.888 and a Composite Reliability of 0.947. Similarly, the Non-Performing Loans (Y) construct obtained values of 0.899 and 0.921 respectively, while the Risk Management Strategy (X1) had a Cronbach's Alpha of 0.889 and a Composite Reliability of 0.917.

Meanwhile, the moderation interaction constructs X1Z1 and X2Z2 show a perfect Composite Reliability value of 1.000. Overall, these results indicate that all constructs in the research model have excellent reliability, so that the measuring instrument used can be considered effective in evaluating the intended construct, and is suitable for application in further structural model testing. This is in line with a study conducted by Rahmawati and Prasetyo (2023) which shows that the constructs in the Islamic finance research framework evaluated using Cronbach's Alpha and Composite Reliability with a value of more than 0.70 show high consistency and certainty of the measuring instrument, so that the tool can be legitimately applied in subsequent analysis (Rahmawati & Prasetyo, 2023).

2.4. Convergent Validity Test

Table 4. Test Convergent Validity Results

	Compliance with SOP (X2)	Internal Conflict of Interest (Z)	Outstanding Interests (Y)	Risk Management Strategy (X1)	X1*Z1	X2*Z2
(X1) * (Z)	0.565	0.416	0.149	0.583	1.000	0.944
(X2) * (Z)	0.530	0.387	0.142	0.570	0.944	1.000
X1.1	0.725	0.193	-0.039	0.858	0.491	0.488
X1.2	0.661	0.227	-0.102	0.762	0.496	0.460
X1.3	0.736	0.259	-0.037	0.824	0.560	0.516
X1.4	0.695	0.399	-0.023	0.872	0.493	0.496
X1.5	0.685	0.331	-0.033	0.829	0.408	0.419
X2.1	0.856	0.416	0.026	0.686	0.413	0.424
X2.2	0.818	0.207	-0.204	0.719	0.443	0.419
X2.3	0.831	0.276	-0.165	0.710	0.574	0.489
Y1	-0.157	0.368	0.874	-0.144	0.145	0.151
Y2	-0.121	0.320	0.894	-0.042	0.171	0.140
Y3	-0.045	0.211	0.814	0.058	0.183	0.192
Y4	-0.063	0.451	0.870	-0.008	0.054	0.050
Z1	0.336	0.950	0.431	0.300	0.349	0.337
Z2	0.375	0.946	0.346	0.385	0.442	0.399

Source: Processed primary data

Based on Table 4, the correlation between indicators and their respective constructs shows a high value (>0.7), such as in indicators X1.1-X1.5 on Risk Management Strategy (0.762-0.872), X2.1-X2.3 on SOP Compliance (0.818-0.856), and Z1 and Z2 on Internal Conflict of Interest (0.946-0.950). This indicates good construct convergent validity. The Non-Performing Loans variable (Y) has the highest correlation with indicators Y2 (0.894) and Y4 (0.870), indicating a strong measurement instrument. However, the direct correlations of constructs X1, X2, and Z to Y are relatively low and partly negative.

The moderation interaction value between X1Z1 and X2Z2 is very high (1.000 and 0.944), indicating that Internal Conflict of Interest (Z) plays a significant role in moderating the relationship between the independent (X1, X2) and dependent (Y) variables. This finding confirms the importance of the moderating role of internal conflicts of interest in the effectiveness of risk management and SOP compliance on reducing non-performing loans. This is in line with the study by Putra and Susanti (2022).

Which shows that the existence of conflicts of interest within the organization plays an important moderating role in the relationship between the implementation of risk management and the quality of non-performing assets in Islamic financial institutions. The study confirms that the existence of internal conflicts of interest can increase or decrease the impact of risk management on credit problems, so the management of internal conflicts of interest is a crucial component in maintaining the financial stability of the institution

2.5. Hipotesis Test

Table 5. Test Hipotesis Results

	T Statistics (|O/STDEV|)	P Values
Compliance with SOP (X2) -> Internal Conflict of Interest (Z)	1.138	0.256
Compliance with SOP (X2) -> Non-performing loans (Y)	2.261	0.024
Internal Conflict of Interest (Z) -> Non-performing Loans (Y)	5.450	0.000
Risk Management Strategy (X1) -> Internal Conflict of Interest (Z)	0.799	0.425
Risk Management Strategy (X1) -> Non-performing loans (Y)	0.103	0.918
X1*Z1 -> Non-performing loans (Y)	0.713	0.476
X1*Z2 -> Non-performing loans (Y)	0.112	0.911

Source: Processed primary data

Based on the findings from hypothesis testing as seen in the t-statistics and p-values, it was found that not all relationships between the variables in this study were statistically significant. The relationship between Compliance with SOPs (X2) and Internal Conflict of Interest (Z) shows a t-statistic of 1.138 and a p-value of 0.256, which means it is not significant at the 0.05 level. In contrast, the relationship between Compliance with SOPs (X2) and Non-Performing Loans (Y) shows significant results with a t-statistic of 2.261 and a p-value of 0.024, as the p-value is smaller than 0.05.

Furthermore, the relationship between Internal Conflict of Interest (Z) and Non-Performing Loans (Y) also proved significant with a t-statistic of 5.450 and a p-value of 0.000. On the other hand, the relationship between Risk Management Strategy (X1) and Internal Conflict of Interest (Z) does not show significance, with a t-statistic of 0.799 and a p-value of 0.425. In testing for moderating variables, the interaction between Risk Management Strategy and Internal Conflict of Interest (X1Z1) on Non-Performing Loans (Y) shows a t-statistic of 0.713 and a p-value of 0.476, while the interaction of Compliance with SOPs and Internal Conflict of Interest (X2Z2) on Non-Performing Loans (Y) shows a t-statistic of 0.112 and a p-value of 0.911. Both interactions are not significant. Therefore, it can be concluded that only some of the relationships between the variables in the model are statistically significant, especially the direct effect of Compliance with SOPs (X2) and Internal Conflict of Interest (Z) on Non-Performing Loans (Y), while other effects, including the moderating role, do not show significant meaning.

This is in line with the research of Rahmawati and Prasetyo (2023) which revealed that compliance with standard operating procedures and management of internal conflicts of interest are crucial factors in reducing the risk of non-performing loans in Islamic financial institutions. In addition, Fithri (2024) also showed that although risk management strategy is a vital element, its impact on reducing non-performing loan risk is strongly influenced by implementation and organizational support, so it does not always produce a significant effect directly. Thus, the results of this study confirm that strengthening compliance with SOPs and controlling conflicts of interest are key steps that need to be considered in the management of non-performing loan risk in Islamic financial institutions.

3. Materials and Methods

This research applies a quantitative approach with a case study method conducted at Baitul Maal wa Tamwil (BMT). Data was collected using an open-ended questionnaire containing questions on risk management strategies, compliance with Standard Operating Procedures (SOPs), agency problems, and non-performing Musyarakah financing, which was addressed to BMT managers or staff who are directly involved in the financing process. Respondents were selected by purposive sampling based on their experience and

involvement in financing and risk management. The data obtained was then analyzed descriptively to identify patterns and relationships between variables.

In this study, there are four main variables, namely Risk Management Strategy (X1), Compliance with Standard Operating Procedure (SOP) as independent variables, Agency Problem (Z) as intervening variable, and Problematic Musyarakah Financing (Y) as dependent variable. The relationship between the four variables is depicted in a scheme that shows the interaction between these variables.

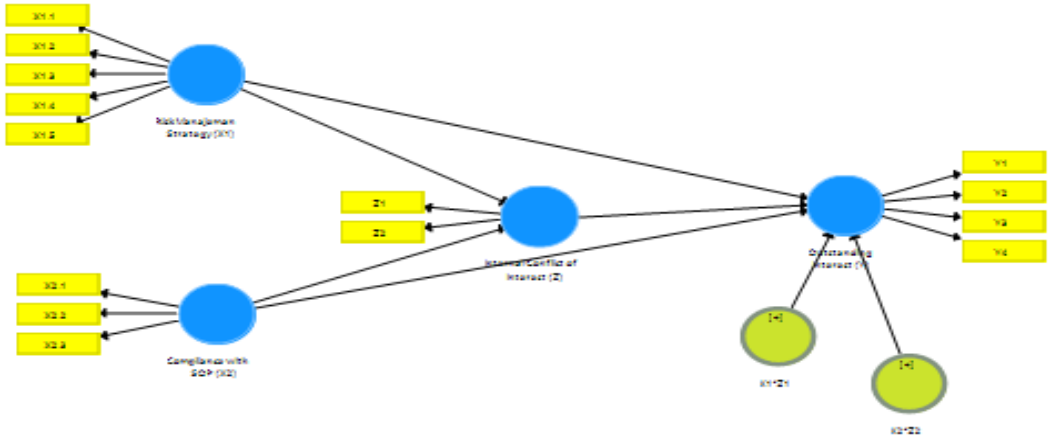

Figure 1. Interaction sceme between variables.

This study proposes several hypotheses related to the effect of risk management on musyarakah financing problems in BMT. The main hypothesis assumes that the implementation of good risk management can significantly reduce the amount of problematic musyarakah financing. In addition, two additional hypotheses are proposed. The first hypothesis states that stricter partner selection and more intensive business supervision can reduce the potential for moral hazard and adverse selection in the contractual relationship between BMT and business partners. The second hypothesis argues that the application of prudential principles in accordance with sharia principles, as well as the preparation of transparent and fair contracts, can improve transparency and accountability, thereby reducing the risk of non-performing financing. This study aims to examine the effect of good risk management on reducing problems in musyarakah financing at BMT.

As for the explanation above, the hypothesis of this study is formulated as follows:

H_0: The implementation of good risk management does not have a significant effect on reducing the amount of non-performing musyarakah financing in BMT.

H_1: Stricter partner selection and more intensive business supervision can reduce the potential for moral hazard and adverse selection in the contractual relationship between BMT and business partners.

H_2: Argues that the application of the precautionary principle in accordance with sharia rules, as well as the preparation of transparent and fair contracts, can improve transparency and accountability, thereby reducing the risk of non-performing financing.

4. Conclusions

This study indicates that the implementation of Islamic risk management strategies does not have asignificant impact on non-performing musyarakah financing in BMT. The p-value was recorded as 0.918 and the t-statistic was 0.103. This indicates that the null hypothesis (H_0) is accepted for the path.

On the other hand, complying with SOPs has a significant impact on non-performing loans, as seen in the p-value of 0.024 and t-statistic of 2.261, which results in the acceptance

of the alternative hypothesis (H_1). In addition, the internal conflict of interest variable is proven to have significance in influencing non-performing financing with a p-value of 0.000 and a t-statistic of 5.450, which highlights the importance of relationship management between BMT and business partners.

Furthermore, the results of the convergent validity test show that all indicators have a loading factor value above 0.7, such as risk management strategy indicators ranging from 0.762 to 0.872, SOP compliance in the range of 0.818 to 0.856, and internal conflict of interest between 0.946 to 0.950, which indicates that this research instrument is valid. The Average Variance Extracted (AVE) value also illustrates good construct validity, where all constructs have an AVE of more than 0.5, such as in internal conflict of interest which reaches 0.899 and non-performing financing which records 0.745. The reliability test showed satisfactory results, as evidenced by the high values on Cronbach's Alpha and Composite Reliability, for example the composite reliability values for risk management strategy reached 0.917 and non-performing loans 0.921, indicating the consistency and reliability of this instrument.

The moderation interaction value between risk management strategy and internal conflict of interest (X1Z1) was recorded at 1.000 and between SOP compliance and internal conflict (X2Z2) at 0.944, indicating that statistically this moderation relationship is quite strong. However, hypothesis testing showed that the moderating effect was not statistically significant on the dependent variable, with p-values showing 0.476 and 0.911 respectively. Therefore, it can be concluded that although internal conflict of interest does not significantly moderate the effect of risk management and SOP compliance on non-performing financing, its existence still plays a key role in strengthening the effect. This finding emphasizes the importance of BMT's focus on improving compliance with sharia procedures as well as strengthening transparency of business partners in order to minimize non-performing financing.

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