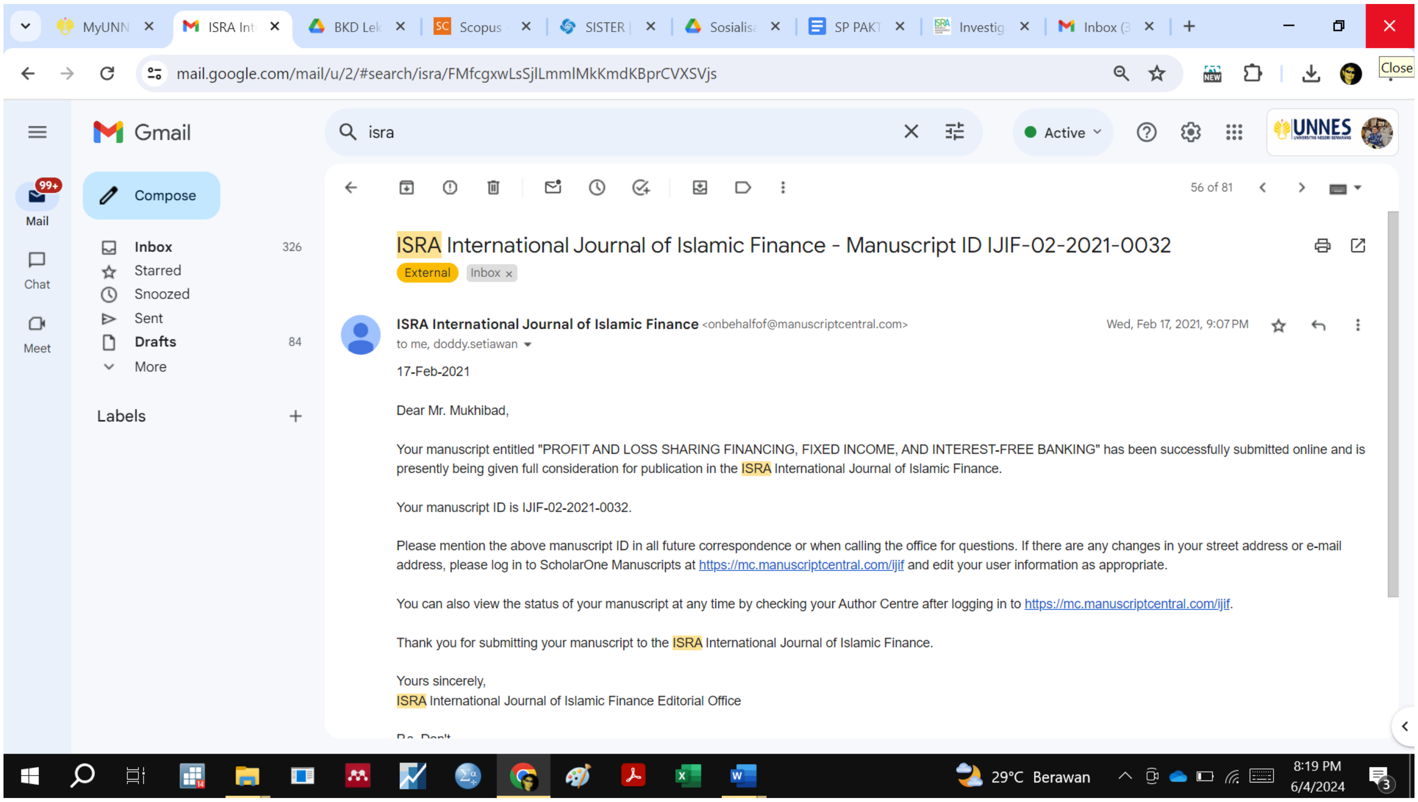
BUKTI KORESPONDENSI JURNAL JUDUL:

**INVESTIGATING EQUITY-BASED FINANCING AND DEBT-BASED FINANCING IN ISLAMIC BANKS IN INDONESIA**

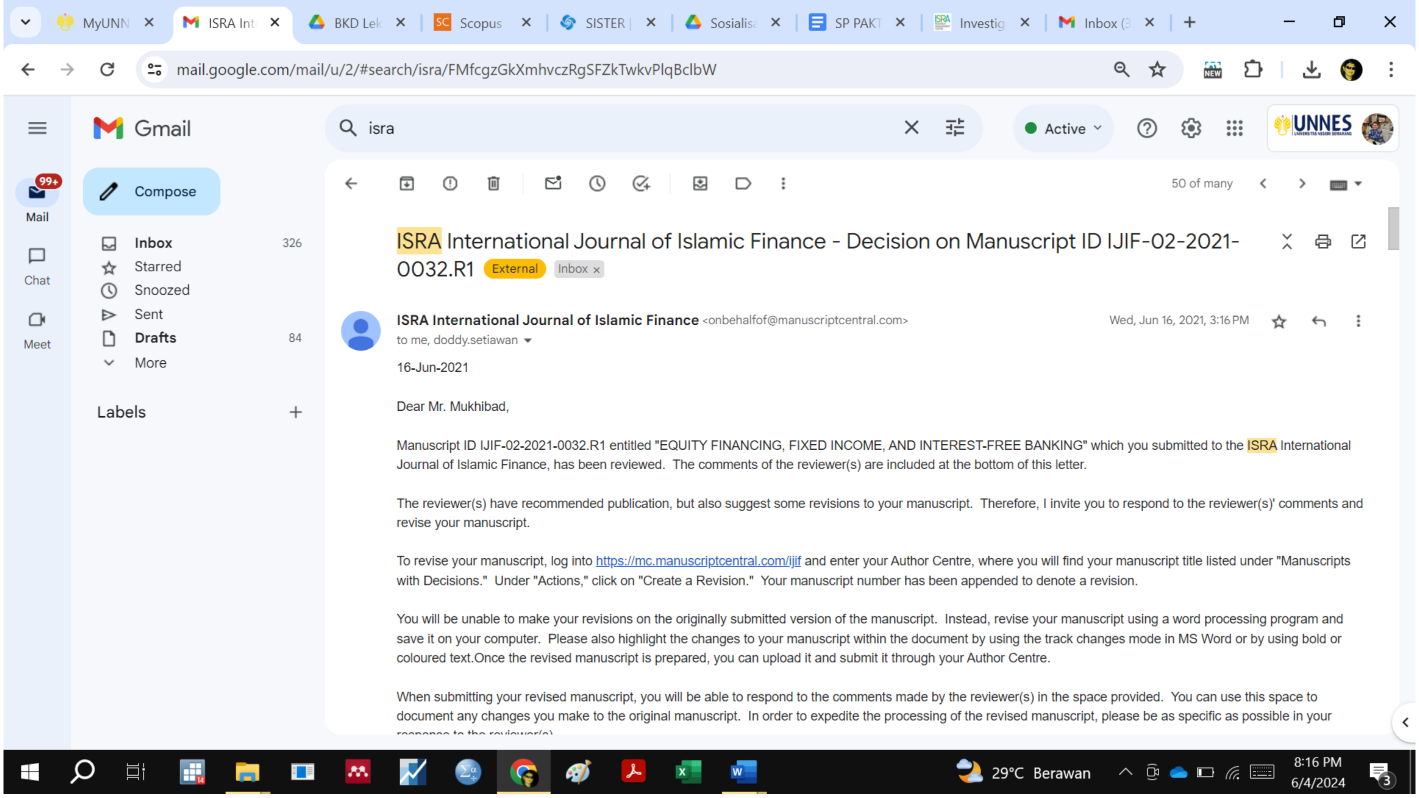
**TERBIT PADA ISRA - INTERNATIONAL JOURNAL OF ISLAMIC FINANCE**

**(INDEKS SCOPUS, Q3)**

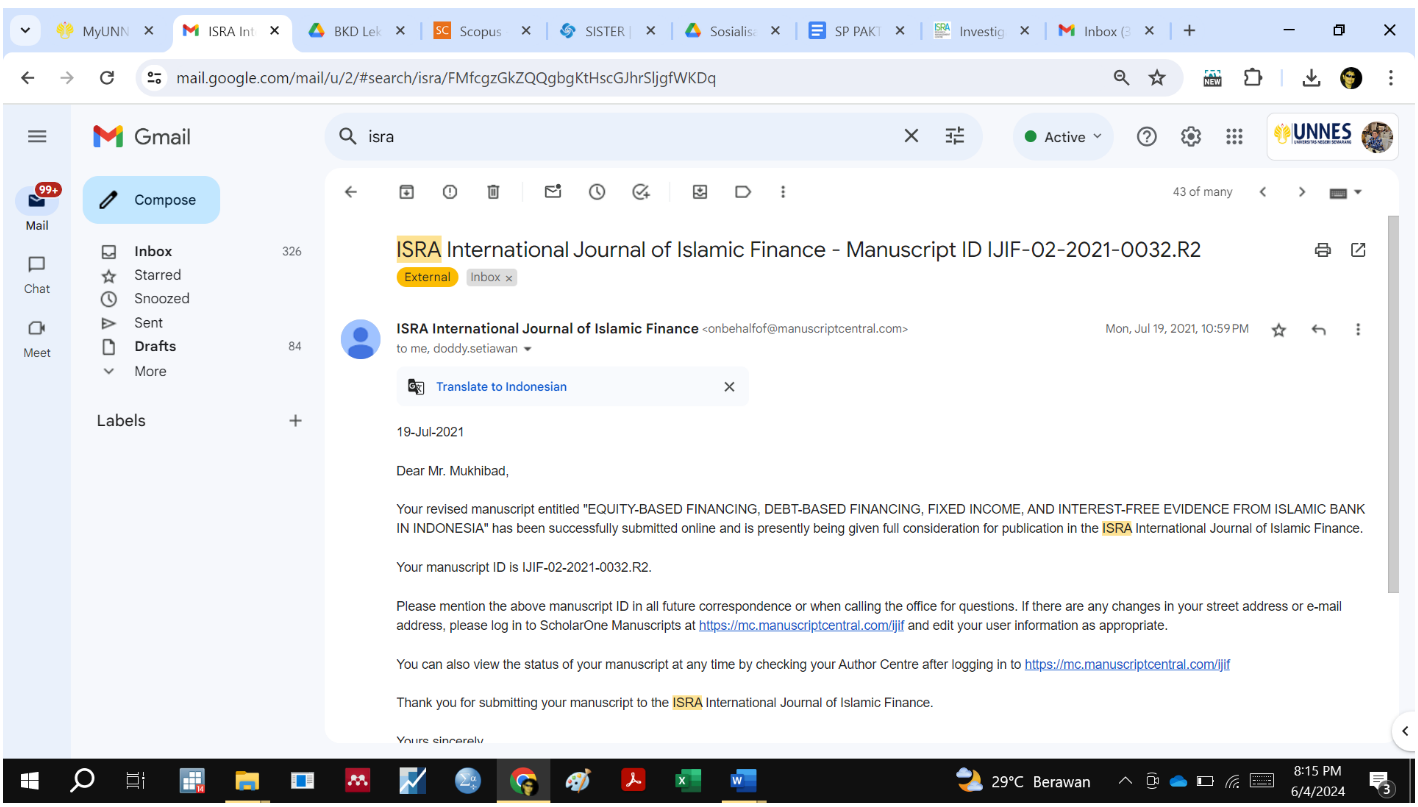
## Proses submit



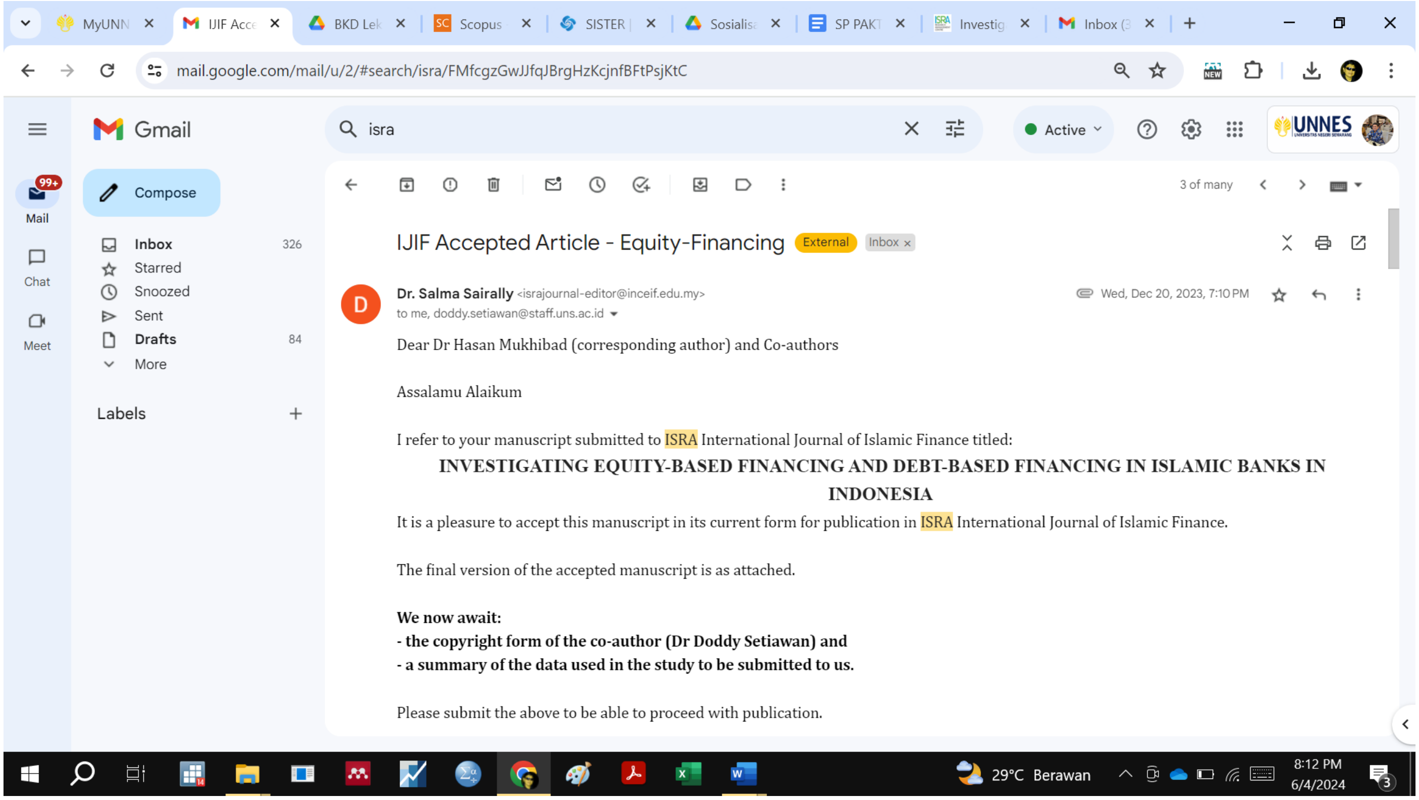

## Komentar Dua Reviewer




**Penerimaan revisi oleh reviewer**




**Penerimaan Artikel**



IJIF Accepted Article - Equity-Financing

Dr. Salma Sairally <israjournal-editor@inceif.edu.my>
to me, doddy.setiawan@staff.uns.ac.id
Wed, Dec 20, 2023, 7:10 PM

Dear Dr Hasan Mukhibad (corresponding author) and Co-authors

Assalamu Alaikum

I refer to your manuscript submitted to ISRA International Journal of Islamic Finance titled:

**INVESTIGATING EQUITY-BASED FINANCING AND DEBT-BASED FINANCING IN ISLAMIC BANKS IN INDONESIA**

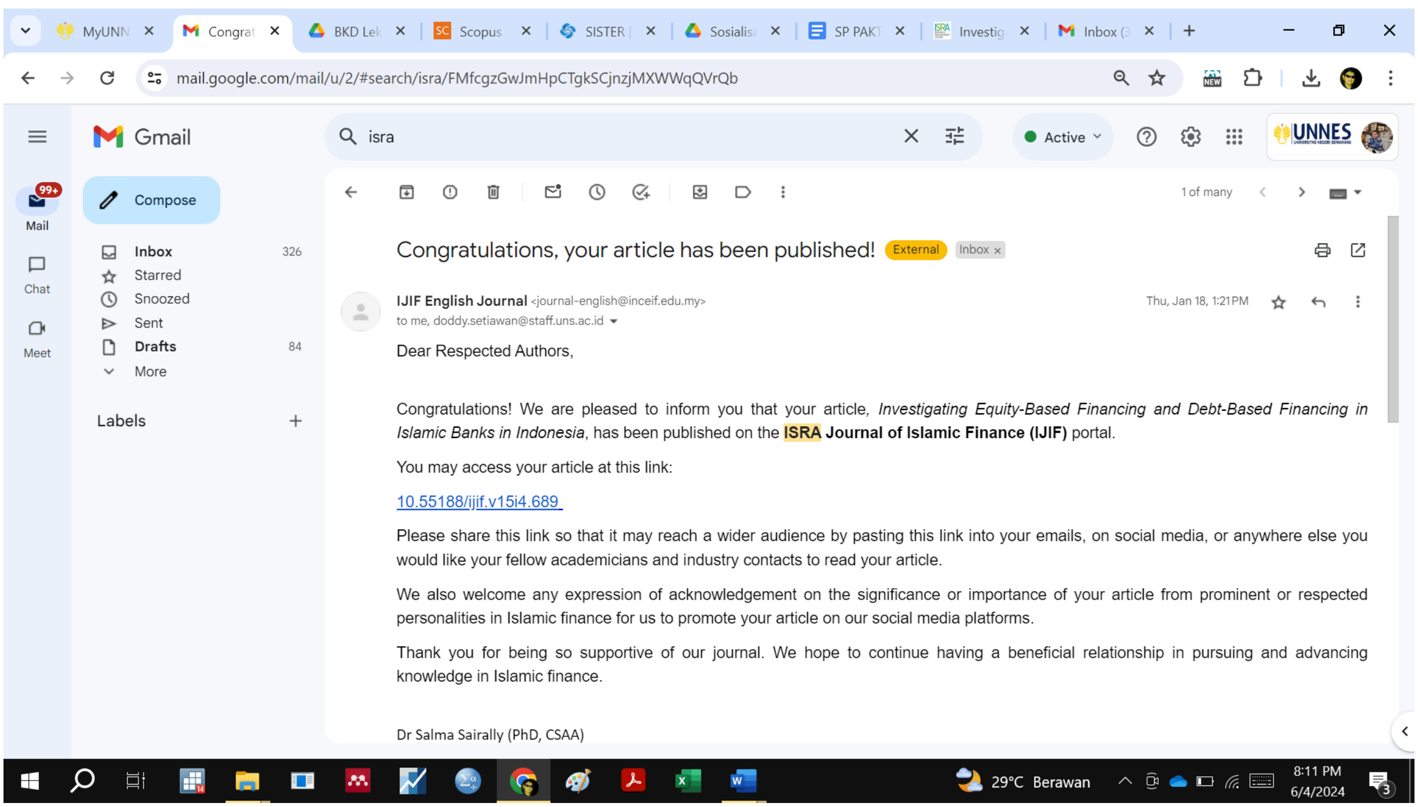
It is a pleasure to accept this manuscript in its current form for publication in ISRA International Journal of Islamic Finance.

The final version of the accepted manuscript is as attached.

**We now await:**
**- the copyright form of the co-author (Dr Doddy Setiawan) and**
**- a summary of the data used in the study to be submitted to us.**

Please submit the above to be able to proceed with publication.

## Pemberitahuan Artikel telah publish



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Dear Respected Authors,

Congratulations! We are pleased to inform you that your article, *Investigating Equity-Based Financing and Debt-Based Financing in Islamic Banks in Indonesia*, has been published on the ISRA **Journal of Islamic Finance (IJIF)** portal.

You may access your article at this link:

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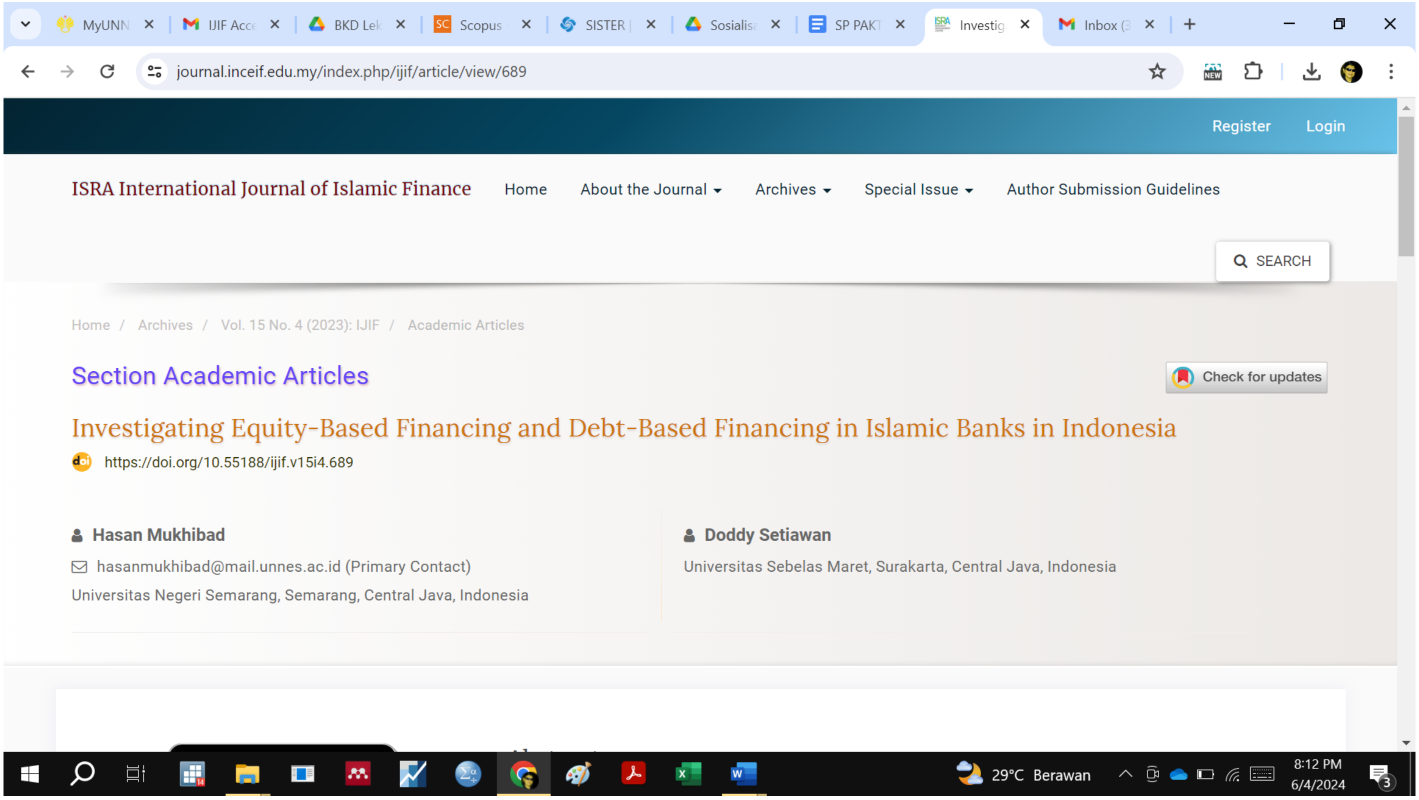
Please share this link so that it may reach a wider audience by pasting this link into your emails, on social media, or anywhere else you would like your fellow academicians and industry contacts to read your article.

We also welcome any expression of acknowledgement on the significance or importance of your article from prominent or respected personalities in Islamic finance for us to promote your article on our social media platforms.

Thank you for being so supportive of our journal. We hope to continue having a beneficial relationship in pursuing and advancing knowledge in Islamic finance.

Dr Salma Sairally (PhD, CSAA)

## Artikel telah Publish




# CATATAN REVISI

## REVISI TAHAP 1

### Referee 1

| Indicators | Comments from Referee | Our Comments/revisions |
|---|---|---|
| Comments | Yes, it is an interesting paper to compare the different rates in both conventional and Islamic banks. However, I have some observations in the paper. | Thank you very much |
| | Based on the hypotheses 3 and 4, the authors have to test the granger-causality test between the conventional and Islamic banks. However, the sample size is only Islamic banks, I wonder how the | I apologize for our mistake. We use conventional bank lending interest rate (CBLIR) as one of the research data. We have added conventional bank (CB) as the research sample. See abstract-with yellow highlight-page 1) |

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| | authors compare between these two without sample of conventional banks. This is my main concern of the paper. | and method part (see page 8, with yellow highlight). |
| | No,, the title is misleading,,, initially I thought how these authors combine equity, sukuk and Islamic banks.. However, the authors focus on different financing types in the Islamic banks. therefore, the authors should revise the title,. | We have changed it to: "Equity-Based Financing, Debt-Based Financing, Fixed Income, and Interest-Free Evidence from Islamic Bank in Indonesia". Thank you very much for your recommendation. See the title-with yellow highlight-page 1) |
| Originality: Does the paper contain new and significant information adequate to justify publication?: | Yes, it is an interesting paper to compare the different rates in both conventional and Islamic banks. However, I have some observations in the paper. | Thank you very much |
| Relationship to Literature: Does the paper demonstrate an adequate understanding of the relevant literature in the field and cite an appropriate range of literature sources? Is any significant work ignored?: | Yes, it is well presented and the hypotheses developments are satisfactory | Thank you very much |
| Methodology: Is the paper's argument built on an appropriate base of theory, concepts, or other ideas? Has the research or equivalent intellectual work on which the paper is based been well designed? Are | Based on the hypotheses 3 and 4, the authors have to test the granger-causality test between the conventional and Islamic banks. However, the sample size is only Islamic banks, I wonder how the authors compare between these two without sample of conventional | Thank you for your correction. We have revised it to: "This study uses as objects islamic bank and conventional banks in Indonesia". See page 8 – with yellow highlight. |

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| the methods employed appropriate?: | banks. This is my main concern of the paper. | |
| Results: Are results presented clearly and analysed appropriately? Do the conclusions adequately tie together the other elements of the paper?: | As i mentioned in my previous section, how the authors get the granger-causality test without sample of conventional banks. Please explain it. | We apologize for this error. In the method section, we use conventional bank lending interest rates (CBLIR), so we have added conventional banks as research samples. Thank you for your correction. See abstract-with yellow highlight-page 1) and method part (see page 8, with yellow highlight). |
| Practicality and/or Research implications: Does the paper identify clearly any implications for practice and/or further research? Are these implications consistent with the findings and conclusions of the paper?: | yes, it is provided, | Thank you very much |
| Quality of Communication: Does the paper clearly express its case, measured against the technical language of the field and the expected knowledge of the journal's readership? | Has attention been paid to the clarity of expression and readability, such as sentence structure, jargon use, acronyms, etc.: All Arabic words must be italic.<br><br>The paper must be proofread by professional language editor if the paper is considered.<br><br>Do the title and abstract clearly indicate the content of the paper? Are all the tables and illustrations | We have revised the title of the paper and this manuscript has been proofread by a professional proofreader – editage). |

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| | necessary? Are there ways in which the article could be shortened without losing value?: No,, the title is misleading,,, initially I thought how these authors combine equity, sukuk and Islamic banks..<br>However, the authors focus on different financing types in the Islamic banks. therefore, the authors should revise the title,. | |

**Referee 2**

| **Indicators** | **Comments from Referee** | **Our Comments/revisions** |
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| Comments | The paper addresses the question of whether the relative levels of income or returns on Islamic financing products are governed by interest rates. The important issue is examined using Granger-causality tests only. As noted in this reviewer report, Granger-causality tests provide some evidence about the direction of causality, but this evidence cannot be conclusive. Stable rates of return on Islamic financing products may behave like interest rates, which are fixed and predetermined a priori. Stability may not be indicative of predetermined rates as reflective of the nature of stable income generated by the underlying assets. | Thank you for. In this revised paper, we have replaced the data analysis method using Vector Error Correction Model (VECM). We use VECM because the VAR Stability test result in the value of modulus less than 1 and indicates that VAR satisfies the stability condition. See our abstract (page 1) and method (page 9) with yellow highlight. |
| | This review report raises some concerns about a number of issues. The most serious of concerns is about the | In this revised paper, we have changed the research method. We |

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| | methodology. Granger-causality tests may provide some evidence about the direction of causality from interest rates to the rates of return or income on Islamic financing products. They cannot shed light on whether the rates of return are predetermined. There are also issues with measurement problems as with the reported figures of GDP, and the reliance on GDP levels rather than GDP growth rates. Given these methodological issues and in the absence of conclusive and compelling evidence, it is difficult to make practical or policy recommendations. | use VECM and data analysis with the following steps:<br>1. Data stationary test, the study used the Augmented Dickey-Fuller test (ADF) and Phillip-Perron (PP)<br>2. Select the optimal lag base on Akaike Information Criteria (AIC).<br>3. VAR stability test using the AR Root table.<br>4. Cointegration test based on maximum eigenvalue and trace statistics.<br>5. Granger causality test.<br>6. Impulse Response Function.<br><br>See page 8-9 with yellow highlight.<br><br>In this revised paper, we do not use GDP as a variable because the VECM test results show that there is no causality between the IB return rate (IBRR) and the CB Lending Interest Rate (CBLIR). In a previous paper (before revision), we found a correlation between IBRR and CBLIR and we used GDP to explain the correlation between IBRR and CBLIR.<br><br>Thank you for the review. |

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| | Some suggestions are made to improve the quality of the paper in terms of including other analytical models such as VAR and Impulse response functions. But these potential improvements cannot provide remedies for the measurement problems and poor communication. | We have improved this article according to reviewers' suggestions. We use VECM. Thank you very much. |
| | There are signs of excellent work in collecting data by the author(s), and attempts are providing a good account of the empirical evidence. But there are still concerns about measurement errors, methodological issues, and quality of communication. This long review report explains some of these issues. And it is hoped that the author(s) will take the humble recommendations included in this review to improve the quality of the paper. | Thank you for your suggestions to improve the quality of our paper. We have revised this paper according to reviewers' suggestions. We hope that this revision meets the expectations of reviewers. |
| | Thus on aggregate, though this reviewer has opted for "Major Revision" based on the willingness to review a more decent version, the serious issues justify "Rejection". | We have revised this paper according to reviewers' suggestions. We hope that this revision meets the expectations of reviewers. |
| Originality: Does the paper contain new and significant information adequate to justify publication?: | 1- The paper addresses the issues of whether equity financing is associated with fixed income, and whether the returns on the financing instruments by Islamic banks are related to interest rates. This is an important issue given the limited evidence and the usual focus placed on sukuk as “fixed income” instruments rather than the “fixed income” on musharakah and | Thank you very much. |

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| | mudharabah financing. As noted by the author(s), previous studies such as Khalidin and Masbar (2017) and Šeho et al. (2020) examine the issue of whether Islamic banking products are genuinely interest-free. Whereas similar studies such Chong and Liu (2009) and Yuksel (2017) focus on savings products, this paper provides new evidence about the relation between the returns on equity-based and debt-based financing. It also considers the relation of returns on equity-based financing with interest rates and GDP. | |
| | 2- The paper is an attempt to provide new evidence about the proposition that equity-based financing generates fixed income through the replication of conventional financial products. The empirical evidence is based on time-series observations from Indonesian Islamic banks and Granger-causality tests. These tests provide only some indication about the cause-effect relationship and direction of causality between two variables. Thus, evidence from Granger causality that interest rates lead the returns on equity financing may be indicative of deviations from the principal purposes and optimal modus operandi of equity financing. In addition, the paper provides further evidence based on Value-at-Risk analysis about the risks to business continuity associated with equity financing. It is not clear how these additional tests | Thank you very much. We have deleted the Value at Risk (VaR) analysis because this analysis is not related to the hypothesis. Our additional test is the impulse response according to the reviewer's suggestion. |

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| | shed light on the empirical question about the direction of causation between income from Islamic financing and interest rates. | |
| | 3- It should be noted that evidence of a significant relationship between income on Islamic banking products and interest rates does not necessarily imply the predetermination of profit rates or benchmarking on interest rates. Furthermore, the income smoothing practices where profit payouts to investment account holders are based on profit equalization reserves may be the source of additional confusion. The objective of income smoothing practices may be to secure a “stable” rather than “predetermined and fixed” rate of return on investment account. These practices may not necessarily mean the predetermination of income on the underlying asset itself. Given the various theoretical interpretations, practical and regulatory issues (see the related Guidance Note from the Islamic Financial Services Board, December 2010), the empirical results should be interpreted with caution. Evidence of co-movement or convergence of the relative income or return on Islamic financing toward deposit rates from conventional banks does not necessarily indicate the predetermination of the rate of return on Islamic financing instruments. | Thank you very much. This study uses IB Financing Return Rate (IBFRR) and CB lending Interest Rate (CBLIR). This study shows that IBFRR and CBLIR are not correlated with each other. These results indicate that Islamic bank financing is interest-free. |

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| | 4- Thus, on aggregate, the paper does contain some new insights about the important issue, but the evidence is rather limited both in time, geographical scope, and methodology. In the absence of robustness tests, the evidence may be regarded as sample dependent. The methodological approach is based on a single test of Granger causality, which may capture the direction of causality but does not offer insights about the nature of this relationship. | Thank you very much.<br>Our study uses the latest data and a long-time span from 2009 to 2019. We started in 2009 because, in 2009, many Islamic banks in Indonesia did spin-offs from sharia business units to become sharia commercial banks. Thus, the results of this study reduce time constraints and the results of this study can be used in other countries.<br><br>In this revised paper, we change the method to VECM with the following stages of analysis:<br>1. Data stationary test, the study used the Augmented Dickey-Fuller test (ADF) and Phillip-Perron (PP)<br>2. Select the optimal lag base on Akaike Information Criteria (AIC).<br>3. VAR stability test using the AR Root table.<br>4. Cointegration test based on maximum eigenvalue and trace statistics.<br>5. Granger causality test.<br>6. Impulse Response Function.<br><br>We believe that this method can improve the quality of the paper. Thank you very much. |

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| 2. Relationship to Literature: Does the paper demonstrate an adequate understanding of the relevant literature in the field and cite an appropriate range of literature sources? Is any significant work ignored?: | 1- The paper is well written insofar that the relationship with literature is concerned. There is a serious attempt to provide a concise account of relevant studies, both at the level of the introduction, literature review and discussion of results. | Thank you very much. |
| | 2- It is argued by the author(s) in page 5 that the Quranic verse 2:275 implies “the legal principle that loss is commensurate with profit and return is commensurate with responsibility (Šeho et al., 2020).” It is not clear how losses can be “commensurate” with profits and returns with responsibilities when losses and profits are mutually exclusive. Profits cannot be proportional to losses and vice versa, as they are mutually exclusive. Returns are also function of the realization of profits or losses. The verse simply states the difference between the permissibility of trade and prohibition of usury. It implies that whereas permissibility can be justified by the notion of profit-loss sharing in the former, impermissibility can be based on the notion of risk transfer in the latter. | We adopt this statement from (Šeho, Bacha, & Smolo's (2020) statement.<br><br>However, we have revised it into the sentence “Interest is an unfair transaction because the profits are realized from load without sharing risk or risk-free (Rosly & Abu Bakar, 2003; Belal, Abdelsalam, & Nizamee, 2015). The argument reflects the legal principle that loss is commensurate with return and earning is commensurate with liability (Šeho et al., 2020)”. (See page 5 with yellow highlight). |
| | 3- It is stated by the author(s) in page 17 that “Yusof et al. (2015) argue that the | As suggested by the reviewer, we replaced the data analysis method |

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| | correlation between revenue sharing and interest may be caused by GDP; GDP is one of the factors that determine interest. Additionally, GDP will also affect the income of IB because IB that use PLS transactions make their income highly dependent on economic growth." It is difficult however to find clear reference to this argument about the GDP in in the study by Yusof et al. (2015). A close argument is made therein in pages 79-80 to the effect that "interest rates fluctuate mainly based on forecasts of future economic activity," and that it is legitimate for Islamic banks to set "profit rates in accordance to what they expect as a profit on economically sound projects funded by the bank which is also linked to the real rates of interest". It is further argued that "the real rate of interest is impacted by factors such as industrial production, unemployment, opportunity cost of capital, etc. which represent factors linked to the real economy." | with VECM. The results of the study found that IBFRR did not correlated with CBLIR. So, in this paper, we do not use the GDP variable anymore and our focus is on answering the hypothesis. Thank you very much. |
| | 4- Thus, it may be argued that GDP growth rate can be taken as proxy for return on the real economy. But it is important to avoid misconceptions leading to potential confusion and misunderstanding in this respect. Yusof et al. (2015) argue that profit rates in Islamic banking may be based on the expected profits generated from projects, and that | Thank you for the advice. We have revised it by not testing the correlation between CBLIR, GDP and IBLRR because the results of VECM analysis found that IBLRR does not correlate with CBLIR. |

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| | the expected level of profits is linked to the real rates of interest. It seems that the "rate of return on the real economy" is confounded with the "real rate of interest". It is important however to make a clear distinction between the "rate of return on the real economy", which reflects the growth rate of the real economy and the "real rate of interest", which is defined as the difference between the nominal interest rate and inflation rate. Both the rate of return on real investment and real rate of interest are driven by expectations and can be determined ex ante. But the issue is whether the realized returns are considered to be fixed and independent of possible states of the world (real rate of interest) or allow to vary depending on the observed performance of the investment projects (return on the real economy). | |
| 3. Methodology: Is the paper's argument built on an appropriate base of theory, concepts, or other ideas? Has the research or equivalent intellectual work on which the paper is based been well designed? Are the methods employed appropriate?: | 1- The empirical analysis is concerned with four null hypotheses about Granger-causality between (1) returns on equity-based and debt-based financing, (2) equity-based financing and debt-based financing risks, (3) return on equity-based financing and interest rates, and (4) return on Islamic financing products and interest rate on conventional banking. | Thank you very much |

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| | 2- With respect to the second null hypothesis, it is stated in page 7 that "[i]n addition to the risk of uncertainty, one of the factors that distinguishes between equity and debt-based financing is credit risk." It is noted that risk should be distinguished from uncertainty, and that uncertainty is not a risk factor. Uncertainty may be understood as the possible existence of two or more states of the world. Obviously, there is no uncertainty in the presence of a single state. There is no risk in case of certainty. In a world of uncertainty, risk can be measured with deviations from the expected value, which is in turn estimated on the basis of probability distribution covering all possible states of the world. | We mean the uncertainty in obtaining returns. In mudharaba and musyaraka financing, banks as *shohibul maal* have uncertainty in getting returns than debt-based financing. However, we have revised this sentence to "The other factors that distinguish between EBF and DBF is credit risk". See page 7 with yellow highlights. |
| | 3- Also in relation to the second null hypothesis, it is stated in page 7 that "[t]he findings of previous studies state that the factors that cause low equity financing are high credit risk." It is further argued that "equity financing unlike debt-based financing, tends to increase credit risk" and that "equity financing can reduce risk." Given the above distinction between risk and uncertainty, it is difficult to understand these statements because equity financing does not increase or reduce investment risk. With respect to credit risk, it is debt-based financing that is associated with credit risk not equity financing since the risk of | Thank you for the review. The hypothesis is that EBF has a greater risk than DBF is based on the findings (Abusharbeh, 2014) (Mukhibad and Khafid, 2018) Grassa (2012) (Misman *et al.*, 2020).<br><br>Every year, the Financial Services Authority (OJK) publishes performance reports of Islamic banks in the form of Islamic banking statistics. In this report, OJK presents NPF or NPL data for each type of financing. The annual report of all Islamic banks in Indonesia also |

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| | default on scheduled payments can only be related to debt not equity. | presents information on NPF/NPL for all types of financing. So that NPF/NPL can occur in DBF and EBF. In EBF transactions in IB in Indonesia, entrepreneurs will return the financing principal and profit-sharing (according to the results of the entrepreneur's performance reported by the entrepreneur) to the bank every month. The late payment results in an NPF.<br><br>However, we add the reviewer's suggestion by writing the following sentence:<br>"The other factor that distinguishes between EBF and DBF is credit risk. (Abusharbeh, 2014) and (Mukhibad and Khafid, 2018), using a sample of IB in Indonesia found a positive relationship between the EBF ratio and NPF. IB in Indonesia prefer to use DBF to control bank risk (Abusharbeh, 2014). Grassa (2012), using a sample of IB in GCC countries, concluded that greater revenue sharing leads to higher levels of risk for IB. Thus, IBs with high EBF tend high credit risk (Misman *et al.*, 2020) (Ariffin, Archer and Karim, 2009) (Khan and Ahmed, 2001). The high credit risk on EBF is due to the |

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| | | high income from EBF (Grassa, 2012). In addition, the high credit risk in EBF due to agency problems (Dar & Presley, 2000; Beck, Demirgüç-Kunt, & Merrouche, 2013); information asymmetry (Warninda, Ekaputra and Rokhim, 2019) (Muda and Ismail, 2010); and moral hazard (Mahmood and Rahman, 2017).<br>On the contrary, other literatures argue that EBF can reduce credit risk (Chong and Liu, 2009) (Zeineb and Mensi, 2014). EBF promote IB to perform due diligence and strict supervision of their financing. In order to avoid moral hazard and adverse selection, IB evaluate entrepreneur eligibility strictly, so that credit risk can be reduced (Warninda, Ekaputra and Rokhim, 2019). (Warninda, Ekaputra and Rokhim, 2019) support this hypothesis and found that the addition of EBF can reduce NPF. The difference in the results of this study provides evidence that there is weak evidence that EBF has a greater credit risk than DBF.<br>However, descriptive findings (table 4) show that EBF has a lower credit risk (4.19%) than DBF (4.24%). This fact is difficult to |

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| | | support the hypothesis that EBF has greater credit risk than DBF. However, we argue that this fact indicates that there is a risk difference between EBF and DBF. In accordance with the purpose of this study is to empirically examines whether EBF similar to DBF, then we develop the following hypothesis:<br>See page 7-8 with yellow highlight. |
| | 4- There are however concerns about the power of Granger-causality tests in providing evidence about the pre-determination of the rate of return on Islamic financing instruments. Generally, Granger-causality tests are part of a battery of preliminary tests that examine the distributional properties of time-series including stationarity and cointegration tests as well as the correlation structure between variables. provide preliminary evidence on the relation between two variables. However, they represent the only tests reported in this paper. For instance, Chong (2009) and Yuksel (2017) used Granger-causality tests, but it is possible as in Yuksel (2017) to include the vector autoregression (VAR) analysis to examine the correlation structure between conventional deposit rates and the profit–loss sharing ratio of Islamic Banks. It is possible to draw on this VAR | Thank you for the advice. We have replaced the method with VECM. In the method section, we have listed the following steps in VECM:<br>1. Data stationary test, the study used the Augmented Dickey-Fuller test (ADF) and Phillip-Perron (PP)<br>2. Select the optimal lag base on Akaike Information Criteria (AIC).<br>3. VAR stability test using the AR Root table.<br>4. Cointegration test based on maximum eigenvalue and trace statistics.<br>5. Granger causality test.<br>6. Impulse Response Function.<br><br>See page 9 with yellow highlight. |

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| | methodological approach to also consider the impulse response functions, which may provide further evidence on the shape and duration or decay of the response of variables to shocks in another. | |
| | 5- Granger-causality tests are based on bivariate regressions, according to the equations described in the paper (should be numbered). F-statistics represent the Wald statistics for the null hypothesis that Y does not Granger-cause X, or b_1=b_2=⋯=b_n=0 for the first equation. Similarly, the null hypothesis that X does not Granger-cause Y is represented by d_1=d_2=⋯=d_S=0 for the second equation. It is stated in page 9 that:<br><br>(1) "there is a causality between the variable X to Y if …" should read "the direction of causality runs from X to Y if …"<br>(2) similar to explanation above.<br>(3) there is no causality (no relationship) between the variables if …".<br>(4) "there is causality between the two if …" should read "the direction of causality between the two variables is not clear if …". | We have replaced the method using VECM, so the equation model has also changed. These changes are presented on page 8 with yellow highlights. |
| | 6- The paper refers to the "equivalent rate" of income on equity-based or debt-based financing, or income on Islamic bank or conventional bank financing. In conventional finance, the notion of annual | Thank you for the advice. Based on the literature, we use the following variables:<br>1. Equity-Based Financing Return Rate (EBFRR) |

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| | equivalent rate refers to the effective or actual rate of interest after taking compounding into consideration. This may be the source of confusion, in particular when the linkage between the "equivalent rate" on equity financing and interest rates is examined. Judging from the definitions included in Table 3, it appears that the "equivalent rate" is measured as the ratio of revenue to average amount of financing. As such, this ratio does not measure the rate of return on investment, and it cannot be construed as "equivalent" to the rate of return. Revenue should be distinguished from return, because profits and losses are measured after accounting for related expenses and costs. It is important tot make this distinction as in Figure 1 where the issue of "income uncertainty" and "income volatility" rather than "return volatility" is rightly addressed by the author(s). Thus, although the "equivalent rate indicator" is used by regulators, it is better to avoid the use of the term "equivalent rate" in the empirical analysis and discussion of results. | 2. Debt-Based Financing Return Rate (DBFRR)<br>3. Islamic Bank Financing Return Rate (IBFRR)<br>4. Equity-Based Financing Risk (EBFRRISK) that measure by Non-Performance Financing (NPF);<br>5. Debt-Based Financing Risk (DBFRRISK) that measure by Non-Performance Loan (NPL);<br>6. Conventional Bank Lending Interest Rate (CBLIR)<br><br>We have used this variable consistently throughout the body of the paper.<br><br>All data are sourced from Islamic banking statistical and Indonesian banking statistical issued by the Financial Services Authority (OJK).<br><br>OJK has published the NPL for each type of financing as shown in table 4.<br><br>See page 9 with yellow highlights. |
| | 7- Reference is made in page 5 to NPL, which should be explained as non-performing loans. The definition of the variables NPL_PLS as the ratio of "non-performing loans" to equity-based | Thank you for the advice. We use Non-Performing Financing (NPF) for Equity-Based Financing and Non-Performing Loans (NPL) for Debt-Based Financing (DBF). |

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| | financing (need to correct debt-based financing in Table 3) may be also misleading because in equity financing, there are strictly no “loans” and no issues of “non-performing loans”. | |
| | 8- It is stated in page 9 that “We further performed stationarity, cointegration, and VAR lag order tests to ensure the correlation between the two variables. We used these tests because they can explain 2-way causality. Further, the type of data we used was in the time series.” Similar statements are also made in page 11 where it is stated that “We performed stationarity, cointegration, and VAR lag order tests before the Granger causality test. We used these tests because they can explain two-way causality. Further, the type of data used was time series data.” It is important to avoid redundant statements. | Thank you. We have revised it. |
| | 9- The theoretical justification for the use of GDP as control variable is not clear. It is tautological that return on investment, whether equity-based or debt-based financing, is intrinsically related to the rate of growth in the real economy. It is stated in page 11 with respect to Table 4 that monthly data are used for 11 years, but there may be measurement problems with different data frequencies. It is understood that returns observations for equity and debt-based financing have monthly frequency whereas GDP growth rates are | Thank you for the advice. GDP data is measured monthly. Data sourced from the Indonesia Statistics Agency (Badan Pusat Statistik – BPS). However, in this revised paper, we no longer use GDP. |

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| | quarterly or annual. Also, it appears from Table 4 that the minimum GDP figure (billion IDR) is 433.33, which casts doubt about the possibility of measurement errors. | |
| | 10- As with the GDP, it is not clear why the notion of Value-at-Risk is used in the present analysis. In particular, it is argued in page 19 that “equity financing has lower potential losses when economic conditions are poor. This economic recession will cause business actors to suffer greater losses. Poor economic conditions will negatively influence equity financing, which is larger than debt-based financing.” This is the essence of equity financing as equity returns are intrinsically related to the performance of the real economy, and thus the growth rate in real GDP. | Thank you very much. We have revised it. In this paper, our focus is to answer the hypothesis. We have deleted the Value at Risk (VaR) analysis because this analysis is not related to the hypothesis. |
| | 11- It seems from tables 4 and 5 that it is the levels of GDP figures that are used in this empirical analysis. Growth rates have a stronger tendency to be stationary, and it is important to compare the results of stationarity tests, cointegration tests and Granger-causality tests based on the GDP levels and differences (growth rates). For the sake of consistency in the methodological approach, it is not the level of GDP but the growth rate of GDP that | Thank you very much for your suggestion. In this revised paper, we no longer use GDP. |

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| | should be used in the analysis of returns on Islamic financing products. | |
| 4. Results: Are results presented clearly and analysed appropriately? Do the conclusions adequately tie together the other elements of the paper?: | 1- It should be stated at this level that it is difficult to draw strong conclusions from weak premises or evidence that is not compelling. The only evidence available is based on Granger-causality tests, but these shed light on the direction of causality that does not allow to state with some level of confidence that the income or rate of return on Islamic financing products is predetermined on the basis of interest rates. | We have supplemented the research method with VECM. VECM analysis uses stages as used by previous studies, including:<br>1. Data stationary test, the study used the Augmented Dickey-Fuller test (ADF) and Phillip-Perron (PP)<br>2. Select the optimal lag base on Akaike Information Criteria (AIC).<br>3. VAR stability test using the AR Root table.<br>4. Cointegration test based on maximum eigenvalue and trace statistics.<br>5. Granger causality test.<br>6. Impulse Response Function. |
| | 2- It is argued by the author(s) in the abstract that "[t]here is a link between interest rates and the equivalent rate of IB financing income due to the role of the GDP. GDP will improve the business performance of customers and subsequently increase the equivalent rate of IB financing income." It is however noted that GDP itself does not improve the business performance of customers, it is just a measure of economic activities. It is | Since we have revised the research method (from granger to VECM), the research results have also changed. In the abstract, we revise the results of the study as follows: "This study provides evidence for the fact that contrary to DBF products, EBF does not have fixed income. EBF in Indonesian IB has been carried out in line with its epistemology. CB Lending Interest |

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| | expectations of positive GDP growth rates that lead to expectations about good business performance. However, the realized rate of return on Islamic financing products will depend on the rate of return in the real economy, and thus the realized profits or losses from real investment projects. | Rate (CBLIR) is correlated with the equivalent rate of IB Financing Return Rate (IBFRR). Further, our result shows that EBF and IB financing line with the epistemology and have implemented the Islamic law”. See page 1 with yellow highlight. |
| | 3- With respect to the statistics of equity financing in Indonesia, it is argued in page 3 that “the debt financing ratio is greater than the debt-based financing ratio, equity financing has a greater growth than debt-based financing… This finding leads to the epistemology that PLS practices are not in line with PLS ontology and leads to PLS non interest-free practices.” It should be noted that higher risk associated with income from equity financing is not a weakness. Theoretically at least, higher systematic risk is associated with higher expected return. Also, suspicions about the certainty of income from equity financing should be founded on the notion of fixed income and risk transfer from banks to investors rather than the notion of steady and stable income. The important distinction should be made between steady and fixed income, which reflect the properties of the income-generating asset. Thus, the finding that the growth rate of equity financing is higher than that of debt-based financing cannot be understood as | Thank you for the recommendations. Table 2 presents the growth of EBF and DBF which shows that Indonesia has a higher EBF growth than DBF. Our proposition that EBF growth leads to EBF practices similar to DBF is based on a study from (Hidayah, Lowe, & Woods, (2019). (Hidayah, Lowe, & Woods's, (2019) study states that IB attempted to translate PLS transactions according to local market preferences by trying to provide a steady income and transfer risk from the bank to the entrepreneurs. (Hidayah et al., 2019) using a qualitative approach and using 11 managers of Islamic banks in Indonesia as part of respondents. We revised the sentence as follows: “This fact becomes a temporary conjecture that the existing weaknesses in EBF such as asymmetric information that results in adverse selection problem |

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| | systematic evidence of deviations from the principle of profit-loss sharing. | and moral hazard, is diminishing (Azmat, Skully and Brown, 2015). Also, sharing risk among banks and entrepreneurs in EBF contracts is reduced. We suspect that the certainty about the acquisition of return on EBF is similar to that on DBF". See page 3 with yellow highlights. |
| | 4- In relation to Table 4, it is stated in page 12 that "[t]he standard deviation of the equivalent rate of equity financing income is 2.09, and that of debt-based financing is 10.81." The standard deviation for the latter is 1.15 not 10.81. | Thanks for the correction. We have revised it. See page 10 with yellow highlights. |
| | 5- The results reported in Table 5 indicate that it is not possible to reject the null hypothesis that the interest rate on conventional banking does not Granger-cause the ratio of income from equity-based and debt-based financing to total financing. It is not possible either to reject the hypothesis that GDP does not Granger-cause the latter ratio. On aggregate, the evidence suggests that the direction of causality runs from both GDP and interest rates toward income from Islamic financial products. | Thank you very much. This revised paper does not use GDP. |
| | 6- It is stated in page 14 that "we tested the relationship of GDP to interest income and the equivalent rate of IB financing income. This test is intended to strengthen the | Thank you very much. This revised paper does not use GDP. |

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| | assumption." It should read "the relationship of GDP to income on IB financing" because the GDP-based test is not related to interest rates from conventional banking. Also, it is not clear which assumption this test is meant to strengthen. If this is to better understand the evidence about interest rates Granger-causing income from Islamic financing products, then it is about an empirical result not about an assumption. | |
| 5. Practicality and/or Research implications: Does the paper identify clearly any implications for practice and/or further research? Are these implications consistent with the findings and conclusions of the paper?: | 1- The paper provides some new evidence about the relationship between income from Islamic financing products and interest rates. There are some concerns about measurement problems and methodological issues. The evidence is neither conclusive, nor compelling because Granger-causality tests may provide some insights on the direction of causality but cannot capture the nature of the relationship. The results suggest that the null hypothesis that interest rates from conventional bank deposits does not Granger-cause the "equivalent rate" from Islamic financing cannot be rejected. However, evidence that interest rates lead income or returns on Islamic financing products does not necessarily imply that the latter is predetermined by the former. | Thank you for the review. In this revised paper, we have used VECM and found that IBFRR and CBLIR are not correlated. All variables are measured by percentage and we obtain this data from the Islamic banking statistical and Indonesia banking statistical issued by the Financial Services Authority (Otoritas Jasa Keuangan - OJK). OJK is the bank regulator in Indonesia. |

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| | 2- From the perspective of policy recommendations, it is difficult to provide make strong suggestions in the absence of conclusive evidence. The important question remains as to whether the returns on Islamic financing products are predetermined and fixed or are intrinsically stable because of the stable cash-flows generated by the underlying assets. It is difficult to settle this important issue on the basis of Granger-causality tests alone, which are suggestive about the direction of causality. Statistical and econometric models can provide useful evidence, which cannot be simply dismissed. As argued by the author(s), further evidence based on retail bank data may strengthen the statistical results. But fundamentally, this is a regulatory and supervisory issue, which is best addressed on the basis of information about the determination of return on Islamic financing products. | Thank you for the review. In this revised paper, we have used VECM and found that IBFRR and CBLIR are not correlated. We have carried out the VECM step, so our results are more valid than the previous paper. |
| 6. Quality of Communication: Does the paper clearly express its case, measured against the technical language of the field and the expected knowledge of the journal's readership? Has | 1- Judging from the typo, grammatical mistakes, and inconsistencies between statements made by the author(s) with statistics reported in tables, it appears that the quality of writing needs to be improved | Thank you. In this revised paper, we have used the term variable consistently. The variable are:<br>1. Equity-Based Financing Return Rate (EBFRR)<br>2. Debt-Based Financing Return Rate (DBFRR)<br>3. Islamic Bank Financing Return Rate (IBFRR) |

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| attention been paid to the clarity of expression and readability, such as sentence structure, jargon use, acronyms, etc.: | | 4. Equity-Based Financing Risk (EBFRRISK) that measure by Non-Performance Financing (NPF)<br>5. Debt-Based Financing Risk (DBFRRISK) that measure by Non-Performance Loan (NPL)<br>6. Conventional Bank Lending Interest Rate (CBLIR)<br><br>This paper has also been proofread by a professional (Editage). |
| | 2- It is argued in page 3 that "Table 2 shows that in the observation years, the Indonesian IB had an average equity financing of 35.45%. The equity financing ratio is lower than the debt-based financing ratio (65.55%). The equity financing ratio is lower than the debt-based financing ratio (65.55%). However, as seen from its growth (lines 3 and 4), equity financing has a greater average growth (26.93%) than the debt-based financing (22.68%)." It is however noted from Table 2 that the average equity financing ratio of 35.46% (not 35.45%) is obviously lower than the debt-based financing ratio of 64.54% (not 65.55%), and that the average growth rates are 27.08% (not 26.93%) and 22.75% (not 22.68%) for equity- and debt-based financing. For the sake of easier reading and to avoid any confusion, it is important | Thanks for the correction. We have revised it. This error is due to data rounding. See page 3 with yellow highlights. |

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| | that information stated in the text is consistent with figures appearing in tables. | |
| | 3- With reference to page 4, it seems that Wadiah is defined (or understood as inclusive of) giro transfer. Generally, wadiah accounts are based on trust with deposits made for custody and safekeeping purposes. Thus, giro transfer is merely part of the type of transactions associated with wadiah accounts. | Thanks for the correction. We have replaced them with "demand deposits". We use this term based on the Islamic banking statistical issued by the Financial Services Authority (OJK). |
| | 4- It is stated in page 6 that "Yusof et al. (2015) found that in the long run, there was no relationship between them Profit Loss Sharing (PLS) rates and Interest rates." Perhaps what is meant is "… no relationship between profit-loss sharing (PLS) and interest rates." | Yusof et al. (2015) found that in the short term, there is a relationship between them Profit Loss Sharing (PLS) rates and Interest rates. However, that in the long run, there was no relationship between them Profit Loss Sharing (PLS) rates and Interest rates. |
| | 5- There is a need to provide further explanation and correct typo or grammatical errors in the following statements.<br>- page 4- "However, the debtor is responsible if they incur a loss following an error or negligence (Warninda et al., 2019)", (using "they" when the debtor is singular).<br>- page 5- It is stated that "This is because PLS is more in line with the basic principles of Islamic finance where there is no income without risk". It should read "… without risk bearing". | Page 4- We have replaced it with "debtor". See page 4 with yellow highlights.<br>Page 5 – We have added the word "bearing". See page 5 with yellow highlights.<br><br>Page 5 – We have added the word "IB". See page 5 with yellow highlights.<br><br>Page 10 – We have revised this variable. |

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| | - page 5- It is stated that "CB interest rates determine the returns of B", which should read "IB".<br>- page 10- Table 3, "debt-based financing" should be perhaps replaced by "equity-based financing" in the description of NPL-PLS.<br>- page 13, "Granger test" and "stationary" should read "Granger causality test" and "stationarity". | Page 13 – We have revised it with the term Granger Causality Test (GCT). See page 12 with yellow highlight. |
| | 6- The statement in page 11 that "Further, the type of data we used was in the time series" needs to be rephrased. | Thanks for the correction. We have revised it to "This study empirically examines causality between variables using time series data". See page 8 with yellow highlights. |
| | 7- VAR is invariably used to indicate vector autoregression (page 9, 11, 13) and value-at-risk (pages 4, 10, 19). It is the former that is usually referred to as VAR whereas the value-at-risk is referred to as VaR. | Thanks for the correction. In this revised paper, we do not use VaR (Value at Risk) because this paper focuses on answering the hypothesis. |
| | 8- It is not clear what is meant by "sequential" financing risk in page 12. | The paper that we have revised does not use figures that explain the development of Equivalent rate equity and debt-based financing. We replace it with an impulse response function. See page 14 with yellow highlight. |
| | 9- The statement in page 19 that "However, Table 4 shows that in 2015, equity financing still produced a higher VAR than | Thanks for the correction. In this revised paper, we do not use VaR (Value at Risk) because this paper |

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| | debt-based financing" is made perhaps with reference to Table 6 not Table 4. | focuses on answering the hypothesis. |
| | 10- In page 20, the statement that "This study proves the debate on whether IB have conducted their normative PLS transactions" should read "This study contributes to the debate …"<br><br>Do the title and abstract clearly indicate the content of the paper? Are all the tables and illustrations necessary? Are there ways in which the article could be shortened without losing value?: There are no major issues with the abstract, which reflects the contents of the paper. The title seems to be too general however, and it is better to focus on the main question of the extent to which the return from Islamic financing instruments may be determined by interest rates. | Thanks for the correction. We have revised it to "This study contributes to the debate on whether IBs have conducted their normative PLS transactions". See page 20 with yellow highlights.<br><br>The title of our paper is: "EQUITY-BASED FINANCING, DEBT-BASED FINANCING, FIXED INCOME, AND INTEREST-FREE EVIDENCE FROM ISLAMIC BANK IN INDONESIA". See page 1 with yellow highlights. |
| Note:<br>We really appreciate and thanks for the constructive comments forwarded by the referee of the paper. We have revised thoroughly the paper based on the referee's suggestion. We believe that by incorporating the referee's comments, it has totally improved the quality of the paper. | | |

**REVISI TAHAP 2**