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Asymmetric Effects of Financing Models on Islamic Rural Bank Profitability: The Moderating Role of Socioeconomic Factors and Credit Risk

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Abstract:
This study aims to analyse the impact of Profit and Loss Sharing (PLS) and Non-PLS financing on the profitability of Rural Islamic Banks (BPRS) in Indonesia, incorporating Non-Performing Financing (NPF), financial literacy, and the inequality index as moderating variables. A quantitative approach is employed, utilizing panel data from BPRS for the period 2011–2024, which includes 644 observations from 44 BPRS in Indonesia. The analysis is conducted using panel data regression and Moderated Regression Analysis (MRA). The findings reveal that PLS financing exerts a positive and significant effect on profitability, whereas non-PLS financing does not exhibit a significant effect. NPF moderates the relationship between PLS financing and profitability in a strengthening manner, while it moderates non-PLS financing in a weakening manner. Financial literacy does not moderate the relationship between PLS financing and profitability, but it diminishes the effect of non-PLS financing on profitability. The inequality index does not moderate PLS financing but reduces the effect of non-PLS financing on profitability. These results suggest that PLS financing is instrumental in maintaining the sustainability of BPRS. Additionally, PLS financing serves as a source of working capital for productive business customers, thereby enhancing the profitability of BPRS.

Keywords: PLS Financing, Non-PLS Financing, Islamic Rural Bank, Profitability

JEL Classification Code: G21, G32, O16

1. Introduction

The financing growth of Islamic Rural Banks (BPRS) from 2020 to 2024 exhibits a notable upward trajectory. According to data from the Financial Services Authority (OJK), total financing rose from Rp10.68 billion in 2020 to Rp16.84 billion in 2024 (OJK, 2024). This trend underscores the enhanced role of BPRS in executing their intermediary functions, particularly in supporting the Micro, Small, and Medium Enterprises (MSME) sector (A. Fauzi & Jubaedah, 2024). Nevertheless, this increase in financing has not been entirely matched by a corresponding rise in stable profitability (Afkar & Purwanto, 2021).

Empirical data indicates that the profitability of BPRS, as assessed by Return on Assets (ROA), exhibited fluctuations during the observed period. Specifically, ROA decreased from 2.01% in 2020 to 1.73% in 2021, subsequently increased to 1.92% in 2022, and further rose to 2.05% in 2023, before ultimately declining to 1.51% in 2024 (OJK, 2024) This volatility suggests that the expansion

of financing has not been entirely effective in generating consistent profits, implying potential inefficiencies in the distribution of (Mukhlis et al., 2025).

According to financial intermediation theory, increased financing is expected to enhance profitability by distributing productive funds to the public (Rahman, 2020). This prompts an examination of the effectiveness of financing and the factors affecting the stability of BPRS profitability, as profit performance is significantly influenced by the quality of financing distribution (Melati et al., 2023). Despite these challenges, BPRSs continue to play a vital role in advancing Islamic financial inclusion, especially within the microfinance and MSME sectors (Melanta & Syarif, 2025). The effectiveness of financing distribution, encompassing both Profit and Loss Sharing (PLS) and non-PLS methods, is a determinant of ROA, as these methods possess distinct characteristics that may differently impact the profitability of BPRS in Indonesia.

Within the framework of financial intermediation theory, prior research examining the relationship between financing and the profitability of Islamic banking, specifically at BPRSs, has produced inconsistent findings. Numerous studies have identified that PLS financing significantly influences profitability (Hidayah & Karimah, 2023; Marliyah, 2021; Yudianto et al., 2024). Meanwhile, other studies have shown insignificant results (Ramadhani et al., 2025; F. K. Hakim & Hasanah, 2020; Argantara & Fitriyah, 2024). Non-PLS financing produced mixed results, with some findings being significant and others not. Consequently, this study re-evaluated its impact on BPRSs (Febriana & Ulya, 2024; Harum & Maulidiyah, 2024; Mahardika et al., 2024; Tuhu, 2023).

The Non-Performing Financing (NPF) of BPRS presents a persistent challenge, as it generally surpasses that of commercial Islamic banks and Islamic business units, exceeding healthy limits. However, it can be mitigated through effective risk management and customer support (Fatoni & Utami, 2019; Hidayah & Tabrani, 2019). Financial intermediation theory posits that an elevated NPF leads to increased losses and diminished bank revenue, whereas a reduced NPF improves financing efficiency and profitability (Dewi et al., 2024), so that NPF is relevant as a moderating variable in the relationship between financing and profitability.

Financial literacy significantly influences customers' capacity to manage financing. High levels of financial literacy enhance the effectiveness and performance of financing activities. Conversely, low financial literacy exacerbates information asymmetry and moral hazard (Rahmat & Yamin, 2024; Akerlof, 1970). Individuals possessing advanced financial literacy are more adept at comprehending financing contracts, managing business cash flows, and meeting repayment obligations. This proficiency consequently diminishes the risk of financing default and affects the degree to which financing contributes to the profitability of BPRS. Thus, financial literacy is regarded as a significant moderating variable in the relationship between financing distribution and profitability.

Meanwhile, the inequality index shows how income is distributed in society, affecting people's ability to get financing (Aginta, 2019). High inequality can limit access to productive financing, lower the quality of financing portfolios, and reduce banks' profitability. On the other hand, fairer income distribution can improve access to financing and make it more effective in generating returns (Salama, 2022). Thus, the inequality index is a suitable moderating variable because income distribution differences can change how financing affects the profitability of BPRS.

The discrepancies observed in previous studies regarding the effects of PLS and non-PLS financing on the profitability of BPRS underscore a gap in the research. Some studies report significant findings, whereas others do not. Additionally, previous research has typically examined these two types of financing in isolation, without incorporating NPF, financial literacy, and the inequality index as moderating variables within a unified model. This study proposes an integrated empirical model to elucidate variations in BPRS profitability in Indonesia. The findings aim to enhance theoretical understanding of the financial performance of Islamic banking and offer practical implications for regulators and stakeholders to improve the effectiveness and sustainability of BPRS performance.

2. Literature Review

Profitability serves as a fundamental indicator for evaluating a bank's financial performance, as it demonstrates the institution's capacity to generate profits through proficient asset management and financing (Andriansyah, 2025). In the context of the Islamic banking sector, particularly BPRS, profitability is affected not only by the bank's internal fund management capabilities but also by the quality of financing, customer conditions, and economic factors that impact the sustainability of intermediation activities (Melati et al., 2023). Prior studies suggest that the profitability of Islamic banks is typically assessed using the ROA metric, which effectively represents a bank's ability to leverage its assets to produce profits (Afkar & Purwanto, 2021). Furthermore, profitability levels are also contingent upon the effectiveness of financing disbursement, whether based on PLS or non-PLS financing, each possessing distinct risk and return profiles.

According to financial intermediation theory, financial institutions serve as intermediaries that facilitate the connection between entities with surplus funds and those requiring funds. This is achieved through the efficient distribution of financing, which promotes the productive allocation of resources and enhances institutional profitability (Diamond, 1996; Hantika, 2023). In this study, BPRS operates as an intermediary institution that collects and distributes funds via PLS and non-PLS-based financing. The effectiveness of this productive financing distribution is expected to enhance the bank's profitability

(Munawarah, 2025). The performance of intermediation may decline with an increase in the NPF ratio, as non-performing loans impede the recovery of funds and diminish the bank's profits (Hakim & Mubyarto, 2022).

The theory of information asymmetry posits that disparities in information between banks and customers can influence both the quality of financing and profitability. Specifically, low financial literacy heightens the risk of moral hazard, while economic inequality elevates the likelihood of adverse selection in financing distribution (Rahmat & Yamin, 2024; Akerlof, 1970). From a macroeconomic standpoint, economic inequality and regional economic dynamics impact the effectiveness of financing and the capacity of Islamic Rural Banks to enhance their profitability. Consequently, these external factors can either strengthen or weaken the relationship between financing and the bank's financial performance (Salama, 2022).

PLS-based financing has the potential to enhance the profitability of BPRS, as the profits generated from customer businesses also contribute to the bank's revenue. Consequently, a greater distribution of profit-sharing-based financing increases the opportunity for profit growth (Maharani et al., 2024; Maulana et al., 2022). Conversely, a low distribution of PLS financing may limit profit opportunities and potentially diminish the bank's profitability (Prayuda & Sakdiah, 2024).

Non-PLS financing boosts profitability by providing stable and predictable income through set margins or fees, ensuring steady cash flow and lowering the bank's risk of loss (Humairah et al., 2025). Increasing non-PLS financing can improve profitability due to uncertain returns; however, too much reliance on it may indicate a lack of optimal partnership-based intermediation in the long run (Harum & Maulidiyah, 2024). Therefore, both PLS and non-PLS financing are crucial for the profitability of Islamic banks, highlighting the need to manage both effectively to improve the bank's financial performance.

The influence of the NPF ratio on the relationship between lending and profitability is elucidated by the quality of lending, which determines the efficacy of a bank's fund disbursement (Munandar, 2020). In PLS-based financing, a high NPF ratio signifies an elevated risk of customer business failure, potentially diminishing profit-sharing income and consequently reducing bank profitability. Therefore, NPF may attenuate the positive effect of PLS financing on profitability. Conversely, when the NPF ratio is low, the quality of financing is enhanced, enabling PLS financing to contribute more significantly to profitability (Dionna & Sholahuddin, 2025; Wujarso, 2021).

In non-PLS financing, the quality of customer payments is crucial for maintaining the stability of margin or ujrah income. Consequently, the NPF level is a determinant of the financing's effectiveness in generating profits (Dewi et al., 2024). A high NPF can diminish the effectiveness of non-PLS financing in profit generation and weaken its impact on profitability. Conversely, a low NPF can enhance the contribution of non-PLS financing to the bank's profitability (Malik

& Sepriani, 2025). Therefore, NPF serves as a moderating variable that can either strengthen or weaken the relationship between both PLS and non-PLS financing and the profitability of Islamic banks.

High financial literacy enhances customers' comprehension of contract mechanisms, payment obligations, and financing risks, thereby fostering discipline and reducing the likelihood of non-performing loans in both PLS and non-PLS financing (Umam & Lestari, 2023). This improvement in understanding leads to more effective financing distribution and ultimately bolsters the bank's profitability. Conversely, low financial literacy may result in misunderstandings concerning contracts, payment obligations, and profit-sharing mechanisms, thereby increasing the risk of default and diminishing the impact of financing on profitability (Hirsanuddin et al., 2025). Consequently, financial literacy is perceived as a factor that can either strengthen or weaken the relationship between PLS and non-PLS financing and bank profitability.

The inequality index shows how fair income distribution is, which can impact how efficiently financing is distributed (Hababil et al., 2024). High inequality levels may limit access to financing in the PLS system, reducing its potential to boost profits. On the other hand, lower inequality promotes economic equality, allowing more access to financing and increasing bank profits (Majid et al., 2025). In non-PLS financing, high inequality can shrink the customer base and slow profit growth. Thus, the inequality index can either strengthen or weaken the link between both PLS and non-PLS financing and the profitability of BPRS (Heron, 2023).

The interconnections among these variables suggest conceptual associations that require systematic description to enhance the clarity and structure of the research rationale. Consequently, elucidating the relationships among the variables under investigation and the direction of the hypothesized effects in this study is essential.

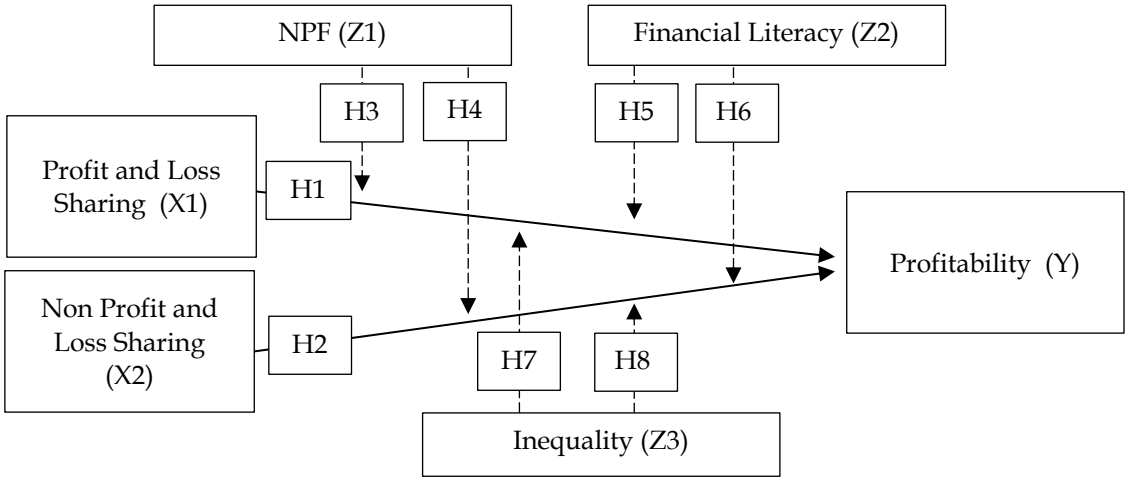


Figure 1: Research Model

Hypothesis

H1: PLS financing affects the profitability.
H2: Non-PLS financing affects the profitability.
H3: NPF moderates the effect of PLS financing on profitability.
H4: NPF moderates the effect of non-PLS financing on profitability.
H5: Financial literacy moderates the effect of PLS financing on profitability.
H6: Financial literacy moderates the effect of non-PLS financing on profitability.
H7: Inequality moderates the effect of PLS financing on profitability.
H8: Inequality moderates the effect of non-PLS financing on profitability.

3. Research Methods

This study utilizes an associative quantitative methodology to examine the effects of PLS and non-PLS financing on the profitability of BPRS in Indonesia, with NPF, financial literacy, and the inequality index acting as moderating variables. The research data comprises financial statements from BPRS institutions registered with the OJK for the period 2011–2024. The data employed are secondary in nature, presented as panel data that integrates both time series and cross-sectional dimensions. The panel data approach was selected due to its ability to amalgamate these two data types, thereby yielding more comprehensive and efficient estimates compared to the use of single data sources (Ghozali, 2018). The application of panel data regression in this study is justified by the presence of heterogeneous characteristics among BPRS that are not directly observable (Ghozali, 2018).

The study population comprises all BPRS in Indonesia registered with the OJK, amounting to a total of 153 BPRS. The research sample was determined through purposive sampling, focusing on the availability and consistency of financial report publications. Consequently, 46 BPRS met the established criteria. The BPRS included in the sample are those registered with the OJK and consistently publishing financial reports throughout the observation period from 2011 to 2024. These criteria were set to ensure data completeness and to support the sustainability of the analysis in alignment with the research objectives.

Table 1: Operational Definition of Variables

Variable	Definition	Measurement
PLS Financing (X1)	PLS financing is a form of financing in which the bank and the customer share both the profits and the business risks in accordance with an agreement (Hidayah & Karimah, 2023).	$PLS = \frac{Mudharabah + Musyarakah}{Total\ Financing} \times 100\%$

Non-PLS Financing (X2)	Non-PLS financing is a form of financing based on a sale or lease, in which profits are derived from a margin agreed upon at the outset (Harum & Maulidiyah, 2024).	$Non\ PLS = \frac{Murbahah + Istishna + Qardh + Ijarah}{Total\ Financing} \times 100\%$
Profitability (Y)	ROA is a profitability ratio used to measure a company's efficiency in generating profits from its total assets (Septiasa & Zuhri, 2020).	$ROA = \frac{Net\ profit}{Total\ Asset} \times 100\%$
Non-Performing Financing (Z1)	The NPF is a ratio of non-performing loans that reflects the asset quality and credit risk level of Islamic banks (Munandar, 2020).	$NPF = \frac{Problematic\ Financing}{Total\ Financing} \times 100\%$
Financial Literacy (Z2)	Financial literacy refers to the level of understanding, attitudes, and behaviors of the public regarding financial products and services (Otoritas Jasa Keuangan, 2022).	Indonesia's Financial Literacy Score (OJK survey results percentage)
Inequality (Z3)	The inequality index measures the extent to which income distribution in a society is equitable (Oladipo, 2025)	Gini ratio score (Percentage of BPS survey results)

Note: Data processed by the author

Data analysis was performed using descriptive statistics and panel data regression in EViews 12. The selection of the optimal panel regression model was guided by the Chow, Hausman, and Lagrange Multiplier (LM) tests (Aprilianti et al., 2022). The Chow test was employed to determine the suitability of the Common Effects Model (CEM) versus the Fixed Effects Model (FEM), with an F probability value greater than 0.05 indicating common effects, and a value less than 0.05 indicating fixed effects (Aprilianti et al., 2022). The Hausman test was utilized to decide between the FEM and the Random Effects Model (REM), where a Chi-Square probability value exceeding 0.05 suggests random effects, while a value below 0.05 indicates fixed effects (Aprilianti et al., 2022). Subsequently, the LM test was applied to compare the REM with the CEM, contingent on the Chow test indicating a CEM, with a probability value less than 0.05 suggesting a REM, and a value greater than 0.05 indicating a CEM (Nasution, 2017).

Hypothesis testing was performed using the t-test to assess the impact of each independent variable on the dependent variable. A probability value of less than 0.05 was considered indicative of a significant effect, whereas a value greater than 0.05 suggested no significant effect (Ghozali, 2018). Furthermore, the coefficient of determination (Adjusted R^2) was employed to evaluate the extent to which the independent variables accounted for the variance in the dependent variable. A value approaching 0 signified weak explanatory power, while a value nearing 1 denoted strong explanatory power (Ghozali, 2018).

Moderation testing was performed using Moderated Regression Analysis (MRA), which incorporates the interaction term between the independent variable and the moderator variable. A moderator variable is deemed significant if the interaction p-value is less than 0.05, suggesting that the variable can either strengthen or weaken the relationship between the independent and dependent variables (Ghozali, 2018). An analytical procedure was utilized to ensure that the constructed model is valid and capable of addressing the research hypotheses.

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3(X_1 Z_1) + \beta_4(X_2 Z_1) + \beta_5(X_1 Z_2) + \beta_6(X_2 Z_2) + \beta_7(X_1 Z_3) + \beta_8(X_2 Z_3) + e$$

Where:
Y : Profitabilitay
X_1 : Financing PLS
X_2 : Financing Non-PLS
Z_1 : NPF
Z_2 : Financial Literacy
Z_3 : Inequality
α : Constant
β : Regression Coefficient
ε : Error

4. Finding and Discussion

The model selection for panel data regression was performed using the Hausman test and the Lagrange multiplier test. The results of these tests are displayed in Table 2 as follows:

Table 2: Chow Test, Haushman Test & Test LM

Test	Probability	Hypothesis Results
Chow Test	0.0000	FEM
Haushman Test	0.9986	REM
Test LM	0.0000	REM

Note: Data processed by the author

The Chow test results indicate a p-value of 0.0000, which is less than 0.05, thereby selecting the Fixed Effects Model (FEM) (Aprilianti et al., 2022). In

contrast, the Hausman test results reveal a p-value of 0.9986, exceeding 0.05, leading to the selection of the Random Effects Model (REM) (Aprilianti et al., 2022). Similarly, the LM Test presents a probability value of 0.0000, which is less than 0.05, confirming that the REM is also suitable for this panel data analysis (Nasution, 2017). Given the selected model, this study does not perform a separate classical assumption test, as the estimation employs a Random Effect Model (REM) with the Generalized Least Squares (GLS) approach, which typically does not necessitate classical assumption testing as required in Ordinary Least Squares (OLS) regression (Basuki & Prawoto, 2016).

Table 3: Determination Coefficient Test

Variable	Coefficient	Statistic	Prob.	R-Square
X1	3.317065	1.626090	0.0418	0.5434
X2	-0.917623	0.517884	0.0769	
X1*Z1	0.913211	0.444297	0.0402	
X2*Z1	-1.66E-09	3.79E-10	0.0000	
X1*Z2	-0.735870	0.437570	0.0931	
X2*Z2	-5.97E-10	2.22E-10	0.0074	
X1*Z3	0.055097	0.354277	0.8765	
X2*Z3	1.15E-07	3.45E-08	0.0009	

Note: Indicates significant at 5% level of significance.

According to Table 3, the findings demonstrate that financing through profit and loss sharing (PLS) significantly affects profitability, thereby supporting the acceptance of the first hypothesis (H1). The positive coefficient indicates that an increase in profit-sharing financing can enhance the profitability of Islamic banks, as this scheme offers greater return potential compared to fixed-margin financing (Ainunsari, 2024). PLS financing, such as mudharabah and musyarakah, enables banks to earn income proportional to the performance of their clients' businesses; consequently, when these businesses perform well, the bank's profits also rise (Rufaida, 2024). The study's results reveal that an increase in PLS financing correlates with enhanced profitability of BPRS, suggesting that profit-sharing-based financing has been effectively implemented and contributes positively to the bank's profit performance (Burhany & Setiawan, 2024). Additionally, this scenario may imply that the bank is proficient in selecting and monitoring customer businesses, ensuring that financing risks are managed effectively and do not impede profitability growth (Siregar et al., 2025). This study is consistent with the research by Hidayah & Karimah, (2023), which asserts that profit-sharing-based financing influences profitability.

Non-PLS financing does not significantly affect profitability. Although this financing type predominates in the distribution of BPRS funds and offers a relatively stable income margin, such an increase does not invariably lead to

enhanced profits (Rahmawati, 2024). Factors such as fixed margins, the risk of non-performing financing, potential customer defaults, and operational costs can constrain its contribution to profitability. Consequently, the impact of non-PLS financing on bank profits was not significant during the study period (Garwautama & Sulaeman, 2021). This finding is consistent with the research by Navita et al. (2023), which also indicates that non-PLS financing does not significantly influence profitability.

NPF moderates the impact of PLS financing on profitability, as evidenced by a significance value below the established threshold, thereby confirming the acceptance of the third hypothesis (H3). The positive interaction coefficient suggests that the presence of NPF enhances this relationship, indicating that an increase in NPF levels amplifies the effect of PLS financing on profitability. In scenarios characterized by elevated financing risk, banks tend to exercise greater caution in customer selection, business viability assessment, and intensive monitoring of customer business performance. This enhanced monitoring quality can improve the effectiveness of PLS financing by ensuring that disbursed funds are allocated more effectively to productive business sectors capable of generating optimal profits (Nisa, 2025). This study corroborates the findings of Hidayah & Karimah (2023), who assert that NPF can moderate the effect of PLS financing on profitability.

NPF moderates the relationship between non-PLS financing and profitability. Given that the significance value is below the threshold, the fourth hypothesis (H4) is accepted. In the scenario where the relationship between non-PLS financing and profitability is not significant and the interaction coefficient is negative, NPF serves as a reinforcing factor. This suggests that a lower NPF ratio enhances the impact of non-PLS financing on profitability. This effect arises because high-quality financing allows banks to sustain margin income while minimizing risk management costs (Kartika & Oktafia, 2021). Consequently, non-PLS financing extended to low-risk customers optimally contributes to bank profitability (Lufitasari et al., 2025). This finding aligns with the research by Faizah et al. (2023), which demonstrates that NPF can amplify the influence of non-PLS financing on profitability.

Financial literacy does not moderate the impact of PLS financing on profitability, as indicated by a p-value exceeding the significance threshold. This outcome can be attributed to the variability in customers' financial literacy levels, which do not yet fully affect the success of profit-sharing financing (Putri et al., 2023). In PLS financing, business success is not solely contingent upon customers' financial understanding; it is also shaped by business conditions, experience, and bank support. Enhanced financial literacy among customers does not necessarily lead to a significant improvement in business performance in the short term. Conversely, customers with lower financial literacy can still manage their businesses effectively if they receive assistance and supervision from the bank (Ramadhan & Sukmana, 2019). These findings align conceptually with the

research by Hutabarat, et al. (2025), which asserts that financial literacy influences financial performance.

Financial literacy significantly moderates the impact of non-PLS financing on profitability, with a significance level below the established threshold. This finding supports the acceptance of the sixth hypothesis (H6). The interaction between non-PLS financing and financial literacy exerts a negative influence on profitability. As previously discussed, non-PLS financing independently has a significant negative effect on profitability. This suggests that high levels of non-PLS financing, when combined with financial literacy, further diminish profitability. Customers with lower financial literacy tend to utilize non-PLS financing more aggressively, resulting in more optimal fixed margins that enhance the bank's profitability. Conversely, customers with greater financial knowledge are more selective and cautious in their use of non-PLS financing, leading to stable but not particularly large contributions to profits (Mulyadi, 2025). Therefore, financial literacy serves as a moderating factor that amplifies the influence of non-PLS financing on profitability under specific conditions.

The inequality index does not significantly moderate the impact of PLS financing on profitability. The results of the MRA test indicate that the inequality index fails to moderate this effect, as its significance value exceeds the established threshold. Consequently, variations in income inequality do not enhance or diminish the influence of PLS financing on profitability. This phenomenon may be attributed to the fact that profit-sharing financing is primarily influenced by the quality of the customer's business, the viability of the project, and the bank's monitoring processes. Despite changes in societal income inequality, banks continue to allocate PLS financing based on business analysis and the potential for profit generation. Therefore, fluctuations in economic inequality have not sufficiently impacted the effectiveness of PLS financing in enhancing profitability. This finding aligns conceptually with the research conducted by Bamberger et al. (2021), which highlights that the Inequality Index does not influence profitability.

The Inequality Index influences the impact of non-PLS financing on profitability. According to the MRA test results, it is evident that the Inequality Index moderates this effect, as the significance value falls below the established threshold. Consequently, the eighth hypothesis is confirmed. The interaction between non-PLS financing and the Inequality Index exerts a positive influence on profitability. Previously, it was noted that non-PLS financing exerts a significant negative partial effect on profitability. This suggests that elevated levels of non-PLS financing, when combined with the Inequality Index, further diminish profitability. Thus, as income inequality rises, the influence of non-PLS financing on profitability tends to diminish.Conceptually, this finding aligns with the research by Oladipo (2025), which emphasizes that the Inequality Index does not affect productivity.

5. Conclusions

This research aims to analyse the impact of PLS and non-PLS financing on the profitability of BPRS in Indonesia, with NPF, financial literacy, and the inequality index acting as moderating variables during the period from 2011 to 2024. A quantitative methodology is employed, utilizing panel data regression and MRA. The sample comprises 46 BPRS registered with the OJK, amounting to a total of 644 observations. Profitability, the dependent variable, is assessed using ROA, while the independent variables include PLS financing and non-PLS financing. The moderating variables are NPF, financial literacy, and the inequality index.

This study concludes that PLS financing has a positive and significant impact on BPRS profitability, whereas non-PLS financing does not exhibit a significant effect. These findings suggest that PLS financing more effectively enhances profitability, as returns are tied to the business performance of customers. In contrast, the contribution of non-PLS financing is limited by factors such as NPF, operational costs, and restricted profit margins. The moderation analysis reveals that NPF strengthens the relationship between PLS financing and profitability by promoting more selective financing practices. Conversely, it weakens the relationship between non-PLS financing and profitability due to increased provisioning costs and reduced margin income. Additionally, financial literacy and the inequality index do not moderate the relationship between PLS financing and profitability. However, both variables negatively moderate the relationship between non-PLS financing and profitability, indicating that higher financial literacy and greater income inequality diminish the effectiveness of non-PLS financing in enhancing BPRS profitability.

The results of this study suggest that BPRS should enhance PLS financing management by improving customer selection, business supervision, and risk management. Concurrently, regulators should strengthen the supervision of financing quality, control of NPF, and financial literacy programs to bolster the stability and sustainability of the Islamic rural banking sector. Nonetheless, the study is constrained by its concentration on financing types, NPF, financial literacy, and the inequality index, which may not encompass all factors influencing BPRS profitability. Consequently, future research should consider incorporating additional variables, such as operational efficiency, bank size, economic growth, and corporate governance, to offer a more comprehensive understanding of the determinants of BPRS profitability in Indonesia.

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