Determinants Profitability of Islamic Banks in Indonesia

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Abstract: The aim of study is to analyse the determination of profitability of Islamic Banks in Indonesia. The sample used of all Islamic banks in Indonesia. Sampling method is purposive sampling and gotten 10 Islamic banks. Data analysed by using panel regression. The results of the research obtained that DER positively effect on ROA, while Operational Costs and Operating Income (BOPO) negatively influence to ROA. The variable NPF and CAR have no significant effect on Return on Assets (ROA) in Islamic Banks in Indonesia.

Keywords: ROA, NPF, DER, CAR,BOPO

1. Introduction

The bank is one of the financial institutions that can encourage the economy of the community and functions to collect and distribute funds to the community. This function must be carried out properly so that the bank's objectives can be achieved. The bank has several types based on the basis of its operations including Islamic banks. Islamic banks are banks that operate based on Islamic sharia principles. Thus, Islamic banks run all of their operations based on the rules established by Islamic sharia (Kasmir, 2010).

Islamic banks in Indonesia were first pioneered by Bank Muamalat Indonesia in 1991 initiated by the Ulama Council of the Indonesian (MUI) and supported by the government and the Indonesian Intellectual Association (ICMI) and several Muslim entrepreneurs. Islamic banks continue to grow and have good performance as evidenced by the improvement of the performance and health of the development bank in 2015. The average performance of Islamic banks reached 3.49% and became the largest contributor to banking growth in Indonesia which grew by around 25 7% compared to the same period the previous year (Financial Services Authority (OJK, 2017).

Many factors can affect the profitability of Islamic banks, including Non-Performing Financing. Non-performing loans will apply to conventional banks, while Islamic banks use non-performing financing (Dendawijaya, 2009). High non-performing financing can interfere with the mobility of bank funds so that it results in a decrease in performance and ultimately a decrease in profitability (YOGIANTA, 2013; Pramana and Mustanda, 2016; Susanto and Kholis, 2016; Thalib, 2016). Debt to Equity Ratio (DER) also effect on profitability which shows the amount of debt held by a bank. The higher the value of debt to equity ratio, the more banks use debt as a source of capital. This will allow banking to pay a lot of its debt so as to reduce its profitability (Sarikadarwati and Afriati, 2016; Amelia Yurike Tamba, Parengkuan Tommy, 2017; Burhanudin, 2017).
Capital adequacy ratio (CAR) is also a contributing factor that can affect profitability. A high CAR make banks stronger in bearing the risk of any risky credit or productive assets and be able to finance bank operations. Finally, it will contribute to bank profitability (Mustanda and Warsa, 2016; Simanjuntak, 2016). Operating costs of operating income (BOPO) also affect bank profitability. The high value of operational costs of operating income indicates that the bank is not efficient in carrying out its operations so that the bank's profitability decreases (Buyung Nusantara, 2005; Aditya Ananda, 2013; Musyarofatun, 2013).

2. Literature Review

2.1 Profitability

Profitability is the ability of company to generate profits in a certain period, the higher the value of the profitability ratio, the greater the profit obtained by a company, (Irawati, 2006; Sudana, 2011; Kasmir, 2014; Susanto and Kholis, 2016). Company profits are derived from company revenues including banking. Some ratios that measure banking profitability include return on assets, return on investment, and earnings per share (Dendawijaya, 2009). Profitability ratios consisting of debt ratio, debt to equity ratio, time interest earned ratio, fixed charge coverage and debt service coverage (Sartono, 2008).

2.2 Non Performing Financing (NPF)

NPF mean the ability of Islamic banking to support the risk of failure of returns, in other words the risk of bad credit, (Dendawijaya, 2009; Musyarofatun, 2013; Susanto and Kholis, 2016). The greater the value of non-performing financing, the lower the profitability of Islamic banking, this indicates non-performing financing has a negative effect on return on assets.

2.3 Debt To Equity Ratio (DER)

Debt to Equity Ratio (DER) is a ratio that describes the long-term debt that a company has with its own capital. Sources of capital derived from debt are used to carry out operations of the company with the aim of obtaining profitability. Thus the debt to equity ratio has a negative effect on profitability (ROA), (Sudaryo, 2012; Mahardhika and Marbun, 2016; Efendi and Wibowo, 2017). The increase in the value of debt to equity is followed by a decrease in the value of return on assets, this is due to the company's advantage is prioritized to repay debt first (Sari and Budiasih, 2014; Dewi, Cipta and Kirya, 2015).

2.4 Capital Adequacy Ratio (CAR)

High value of Capital Adequacy Ratio (CAR) can increase profitability, namely return on assets, which means that capital adequacy ratio has a positive effect on ROA (Agustiningrum, 2013; Bateni, Vakilifard and Asghari, 2014; Bernardin, 2016; Almazari and Alamri, 2017; Udom and Eze, 2018). Banks that have a good capital adequacy ratio reflect good performance.
2.5. **Operational Income Operating Costs (BOPO)**

Operational Costs of Operating Income (BOPO) describe the level of efficiency of a bank in running its business, namely credit (Hasibuan, 2008; Veithzal, 2013). If the value of the operating costs of high operating income indicates that the cost is not efficient in carrying out its business activities and will have an impact on reducing the level of profitability, one of them is return on assets, (Guorong Jiang, Nancy Tang, 2003; Sudarmawanti and Purnomo, 2015; Kurniasari, 2017).

3. **Research Methods**

The population in this study were all Islamic banks in Indonesia during the 2013-2016 and gotten 10 banks. Then sampling technique was carried out by purposive sampling and the type of data used by panel data and data collection techniques were documentation studies. Furthermore, this study used a quantitative approach to test hypotheses, then analyse the data using panel data regression with equations

\[ Y_{it} = \alpha + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \beta_4 X_{4it} + e_{it} \]

- \( Y_{it} \) = Profitability (ROA) at bank \( i \) and period \( t \)
- \( \alpha \) = Constant
- \( \beta_1-\beta_4 \) = Coefficients Regression
- \( X_{1it} \) = NPF at bank \( i \) period \( t \)
- \( X_{2it} \) = DER at bank \( i \) period \( t \)
- \( X_{3it} \) = CAR at bank \( i \) period \( t \)
- \( X_{4it} \) = BOPO at bank \( i \) period \( t \)
- \( e_{it} \) = Error term at bank \( i \) period \( t \)

4. **Result And Discussion**

4.1 **Model Selection Technique**

In case of selecting the correct model requires testing the model on the panel data. The results of the chow test can be seen in Table 1 below.

<table>
<thead>
<tr>
<th>Table 1. Chow Test</th>
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<tbody>
<tr>
<td>Effects Test</td>
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<tr>
<td>Cross-section</td>
</tr>
</tbody>
</table>

Based on table 1 above, it shows that the Chi Square Probability Test value is 0.0021. This value is significant at the level of 5% and chosen model is FEM. And then the Hausman test to determine the appropriate model between FEM and REM. The results of the Hausman test can be seen in table 2 below.

<table>
<thead>
<tr>
<th>Table 2. Hausman Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Test Summary</td>
</tr>
<tr>
<td>Cross-section</td>
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<tr>
<td>random</td>
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</tbody>
</table>
Based on the table above the results of the Hausman Test have a probability value of 0.4894. This value is not significant at the 5% level. Then the chosen model is REM.

4.2 Data Panel Regression Estimation

Effect Model REM, the results of panel data regression can be seen in table 3 below.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficients</th>
<th>T test</th>
<th>Prob</th>
</tr>
</thead>
<tbody>
<tr>
<td>NPF</td>
<td>-0.0500</td>
<td>-0.5583</td>
<td>0.5801</td>
</tr>
<tr>
<td>DER</td>
<td>0.1932</td>
<td>3.7333</td>
<td>0.0007</td>
</tr>
<tr>
<td>CAR</td>
<td>0.5994</td>
<td>1.6972</td>
<td>0.0985</td>
</tr>
<tr>
<td>BOPO</td>
<td>-2.8464</td>
<td>-3.7097</td>
<td>0.0007</td>
</tr>
<tr>
<td>C</td>
<td>10.9879</td>
<td>2.9243</td>
<td>0.0060</td>
</tr>
</tbody>
</table>

Table 3 above shows the NPF and CAR variables are not significant at the 0.05 level, while the DER and BOPO variables are significant at the 0.05 level.

All of management bank effort to increase their performance and keep the trust of customers or the publics. Manager also evaluates the financial statement to make sure the existence of the business either balance sheet or income statements. So, the results of this study show that NPF does not significantly influence the ROA of Islamic Banks in Indonesia. This indicates that banks that have good performance have never considered credit risk as a threat in improving their performance, (Sucianti and Naomi, 2009; Musyarofatun, 2013; Pratiwi and Wiagustini, 2015; Septiani and Lestari, 2016).

Then, DER has a positive and significant effect on ROA of Islamic Banks in Indonesia. This result shows that the increasing DER will increase ROA. This indicates that capital sources of debt originating from debt can expand its operations, thus impacting an increase in ROA. These results are consistent with past study (Ramadhan, Marlina Widiyanti and Taufik, 2016; Sarikadarwati and Afriati, 2016; Thalib, 2016; Burhanudin, 2017).

Furthermore, CAR has no significant effect on the ROA of Islamic Banks in Indonesia. It is because Islamic banks in Indonesia and other banks have been given standards by Bank Indonesia regarding the minimum capital adequacy of a bank in operation. This has been maintained well at a time when banks have increased profits or increased profits, so the CAR is not related to profitability (ROA). This result is consistent with the study (Musyarofatun, 2013; Pratiwi and Wiagustini, 2015; Bernardin, 2016; Thalib, 2016; Amelia Yurike Tamba, Parengkuan Tommy, 2017). And the BOPO have a negative and significant effect on ROA of Islamic Banks in Indonesia. Increasingly, BOPO is decreasing ROA. This result is in line with the previous study, (Musyarofatun, 2013; YOGIANTA, 2013; Pratiwi and Wiagustini, 2015).

5. Conclusions

Based on the result of the study conclude that NPF has no significant effect on ROA. It shows that NPF are not a risk to Islamic banks in Indonesia. DER has a positive and significant effect on ROA. This indicates that the DER is increasing, ROA also
increases. CAR has no significant effect on return on assets (ROA), because Islamic banks already have a standard in maintaining capital adequacy. Operational income operating costs (BOPO) have a negative and significant effect on return on assets (ROA), the higher the operating costs, the lower the profits.

References

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