



CAPITAL, EFFICIENCY, NON-PERFORMING FINANCING AND PROFITABILITY: SHARIA BANKS IN INDONESIA

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ABSTRACT

This study aims to examine the influence of the variable capital adequacy, efficiency, and financing problems on the profitability of Islamic banks in Indonesia. This type of research uses explanatory research using secondary data in the form of financial ratios from 2015 to 2019. The population in this research is 14 Islamic banks in Indonesia. By using the purposive side, the research sample was 13 Islamic banks and 65 data. The data analysis technique used multiple regression and included a normality test, classical assumption, F-test, hypothesis test, and determination coefficient test. The results of the study concluded that the variables of capital adequacy, efficiency, and financing problems had a significant effect on the profitability of Islamic banks in Indonesia. The results of this study support the theory of efficient capital structure, although the composition of Islamic bank capital comes mostly from externals, because Islamic bank management is very efficient in managing funding and financing activities and can manage banks prudently where Islamic banks can suppress problematic financing, Islamic banks can achieve high profit. This is also supported by the existence of a temporary syirkah fund source of capital that is neither a type of debt nor owner's equity. Temporary syirkah funds are a very efficient source of funds for Islamic banks because the bank will reward the owners of temporary syirkah funds only if the bank makes a profit. Conversely, if a Sharia bank does not gain a profit, aka a loss, then the Sharia bank does not provide returns to the owner of temporary syirkah funds. This is the advantage of Islamic banks compared to conventional banks.

Key words: capital, efficiency, risk, financing

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1. INTRODUCTION

Sharia banks are banks that always follow sharia principles in carrying out all their activities. In collecting Islamic commercial bank funds in the form of deposits and investments, Islamic

commercial banks use the wadi'ah contract, the mudharabah contract, and other contracts that do not violate sharia principles. In 2019, there were 14 registered Sharia Commercial Banks (BUS), namely 1,875 offices, 20 Sharia Business Units with 340 offices, and 167 Islamic People's Financing Banks with 495 offices (Sharia Banking Statistics, 2018). In 2018, Islamic commercial banks had a capital of 20.39%. The distribution of financing was 12.21% and third party funds of 11.14% experienced growth from the previous year. Until the end of 2018, the total assets collected by Islamic banking were IDR 489.69 trillion. Sharia banking liquidity is indicated by the ratio of financing to funding that is maintained in the range of 80-90%. Non-performing loans decreased by 2.85%, this shows that credit risk shows improvement. (Sharia Banking Statistics, 2018).

Profitability is an indicator that can be used as a benchmark to determine the performance of a bank. If the public knows that the bank's performance is good, of course, public confidence in the bank will also increase, and vice versa, public trust in the bank will decrease if the public knows the bank's performance is not good. In this study, researchers will proxies profitability by using Return On Asset as a measure of the performance of a bank, bank management uses Return On Assets to measure the ability to obtain overall profits. If the profitability is greater, it means that financial performance is also getting better. Return On Asset was chosen as a measure of performance because Return On Asset can be used to measure the ability of bank management to gain overall benefits. If the profitability is greater, the level of profit that will be obtained by the bank will also increase and the position of the bank and in terms of asset use will improve. The level of profitability of sharia banks should be given more attention because the high level of profitability is a reflection of better banking growth.

Capital adequacy relates to the capacity of the bank in managing capital about assets at risk. When banks can process capital properly and avoid existing risks, all bank activities can run efficiently, so that the profitability of the bank is expected to continue to increase and vice versa (Pramudhito, 2014). Almunawwaroh and Marliana (2018) state that capital adequacy and problematic financing have a significant negative effect on Return On Assets. However, research conducted by Munir (2017) states that Capital Adequacy has a significant effect on Return on Assets, and financing problems have a positive effect on Return On Assets.

In managing their financing, sharia banks have problematic financing. Problematic financing often occurs because banks are too expansive in targeting cost distribution, such as banks providing excessive financing to customers and these customers cannot pay for it, this can harm both investors and banks. Determination by Bank Indonesia in determining non-performing financing is a maximum of 5%. Non-performing financing is a comparison between total non-performing financing and total financing obtained by debtors. When a bank has a large enough problem financing, it will affect the bank's performance, the bank's profit will decrease and will affect its profitability.

To measure the level of efficiency and the ability of a bank to operate its operational activities, it can be done by knowing the ratio between operating expenses and operating income. Each increase in efficiency shows that the bank is less capable of managing its business. Each operational cost has increased, it will result in a decrease in bank profitability due to reduced profit before tax (Dendawijaya, 2009). Previous research has also proven that efficiency has a positive effect on Return On Assets. Ariani and Ardiana (2015) state that efficiency harms Return On Assets. However, Harianto (2017) states that there is a positive effect of efficiency on Return On Assets.

Annual reports held by sharia banks are very useful for various parties so that annual reports need to be analyzed. The tool used to analyze annual reports is financial ratios, wherein the annual report various ratios can be used as a reference in the level of bank performance assessment. The purpose of the researchers conducting this research is to analyze the effect of

capital adequacy, non-performing financing and efficiency influence the profitability of sharia banking.

2. LITERATURE REVIEW

2.1. Sharia Agency Theory

According to Roziq (2020), sharia agency theory explains that in the financing of profit sharing systems such as mudharabah and musyarakah financing. In mudharabah financing, the Islamic bank acts as the owner of the funds (shohibul maal) which can be called the principal while the fund manager (mudharib) is generally the entrepreneur acting as an agent. In musyarakah financing, Islamic banks act as owners of funds (shohibul maal), which can be called passive partners, while business and fund managers generally act as active partners acting as agents. In the implementation of mudharabah and musyarakah financing, agency conflicts arise, causing problems in the financing of the profit sharing system, including (a) the risk of financing the profit sharing system is very high; (b) mudharabah and musyarakah / syirkah financing is less profitable for Sharia commercial banks; (c) the revenue sharing financing system is complicated / difficult to implement; (d) human resources for Islamic commercial banks are less supportive of the implementation of profit sharing systems; (e) requires higher effort; (f) requires multiple reports of an administrative nature; (g) requires more time for customer maintenance so that it affects the productivity of marketing staff; (h) requires in-depth supervision of the use of financing funds; (i) moral hazard / bad character of entrepreneurs; (j) information asymmetry; (k) side streaming; (l) tendency to report high costs in order to pay minimal revenue sharing; (m) reduce income; (n) do not produce financial reports; (o) refuses to be audited; (p) the customer has difficulty in making reports / calculations as a basis for the results; (q) tendency to report low revenue in order to pay minimal revenue sharing and; (r) the customer is not communicative.

Conflicts that occur between parties who carry out an alliance/partnership in a business such as the musyarakah / syirkah and mudaraba contracts have been explained by Allah SWT in a letter in the al-Quran surah as-shad verse 24 and conflicts occur due to the absence of honesty, openness then Allah SWT does not give blessings in every fellowship as explained in the hadith narrated by Bukhari. Allah has given instructions in the Koran surah as-sad verse 24 that all partners/parties who carry out an alliance or partnership in a business must run the business with good deeds and obey in carrying out the provisions of Islamic sharia. Likewise, in a hadith, the Prophet Muhammad SAW has exemplified in running a business and partnerships, the Prophet Muhamad SAW has implemented Islamic business ethics which includes tabligh, mandate, fathonah and shidiq.

2.2. Sharia Bank

Sharia banks are banks whose activities are based on sharia principles, where their activities are not charged interest to customers. Islamic banks get a reward depending on the contract or agreement agreed upon by the customer and the bank. Agreements and contracts agreed upon by both parties must be by the terms and conditions of the contract contained in Islamic law (Ismail, 2011: 32). In the Sharia Banking Law No.21 of 2008, it is stated that sharia banking is part of the sharia bank as well as the sharia business unit which covers all business activities from methods, processes, to the implementation of activities. Islamic banking is divided into Islamic commercial banks, business units, sharia, as well as Islamic public finance banks which in the implementation of their business activities are based on sharia principles (Ismail, 2011: 33)

3. RESEARCH METHOD

In conducting this research, researchers used quantitative explanatory research methods. Explanatory quantitative research aims to explain the effect of the relationship between the independent variable and the dependent variable by testing the hypothesis. The use of quantitative research methods will result in a significant relationship between the independent variable and the dependent variable being studied. Sugiyono (2014: 7) in his book explains that the quantitative research method is considered a scientific method because it is by scientific principles that include concrete/empirical, objective, measurable, rational, and systematic. The population that researchers use in conducting this research are companies. Islamic commercial bank subsector that has been registered with the Financial Services Authority (OJK). While the technique used in taking samples is the purposive sampling method. In conducting research, researchers use secondary data, namely research data that is not obtained directly but through certain intermediaries. The method used is the documentation technique by combining all the data that is the object of the research. The data was obtained through the annual reports of sharia banking subsector companies registered with the OJK through the official website of the OJK (www.ojk.go.id) during 2015-2019. Secondary data includes the annual report of the sharia banking sub-sector companies for 2015-2019, the company's financial ratios consisting of capital adequacy, financing problems, efficiency, and profitability for 2015-2019. The data analysis technique used to examine the effect of the variable capital adequacy, financing problems, and efficiency on the profitability of sharia bank in Indonesia uses multiple regressions.

4. RESULTS OF RESEARCH

The following is an explanation of the performance achievements of Islamic banks in terms of profitability, capital adequacy, efficiency, and problematic financing. The level of profitability of Islamic Commercial Banks (BUS) should be paid more attention because the high level of profitability is a reflection of better banking growth. Better bank performance is indicated by high capital adequacy. When a bank has a large enough problem financing, it will affect the bank's performance, the bank's profit will decrease and will affect its profitability. The condition of each Islamic commercial bank is considered quite good in operating its operational system, this is because the problematic financing owned by each Islamic commercial bank is below 5% (Sharia Banking Statistics, 2019). To measure the level of efficiency and the ability of a bank to operate its operational activities, it can be done by knowing the ratio between operating expenses and operating income. Each increase in efficiency shows that the bank is less capable of managing its business. Each operational cost has increased, it will result in a decrease in bank profitability due to reduced profit before tax (Dendawijaya, 2009). In summary, the performance achievements of sharia banks from 2015 to 2019 can be seen in Table 1 below.

Table 1 Profitability, Capital Adequacy, Problem Financing and Efficiency Sharia Bank in Indonesia

Year	2015	2016	2017	2018	2019
Profitability	0,49 %	0,63 %	0,63 %	1,28 %	1,58 %
Capital Adequacy	15,02 %	16,63 %	17,91 %	20,39 %	20,10 %
Non- Performing Financing	2,77 %	2,07 %	2,13 %	1,74 %	2,07 %
Efficiency	97,01 %	96,23 %	94,91 %	89,18 %	86,26 %

Source : OJK (2019)

Based on the table, it can be seen that the profitability of sharia in 2015-2019 has increased, in 2015 by 0.49%, 2016 to 2017 by 0.63%, 2018 by 1.28%, and in 2019 it increased. by 1.58%. This illustrates if a bank is considered capable of increasing its capabilities in asset management to gain profit. Based on the table, it can be seen that the capital adequacy of sharia banks in

2015-2019 has increased in 2015, namely 15.02%, 2016 at 16.63%, 2017 at 17.91%, 2018 by 20.39. %, and in 2019 amounted to 20.10%. The capital adequacy of sharia banks is always above 8%. This indicates that banks are able to maintain adequate capital in various situations. If seen from the data in Table 1, it can be seen that non-performing financing at sharia banks in 2015-2019 has fluctuated, in 2015 it was 2.77%, 2016 decreased by 2.07%, 2017 amounted to 2.13%, and in 2018 it was 1.74%, and in 2019 it increased by 2.07%. From the table below it can be seen that if there was a decrease in efficiency in sharia banks in 2015-2019, 2015 amounted to 97.01%, 2016 decreased by 96.23%, in 2017 it was 94.91%, in 2018 it was 89.18 %, and in 2019 it was 86.26%.

4.1. Classic Assumption Test

There are several assumptions that must be met in doing before testing the hypothesis, namely the classical assumption test which is used to test whether it can meet the classical assumptions. This is done to avoid biased estimates, considering that not all data can be applied regression. The purpose of the classical assumption test in this study is to determine whether the existing regression model is free from the problem of classical assumptions. The following is a recapitulation of the results of the assumption tests carried out in this study:

Table 2 Summary of Classical Assumption Test

No.	Type of Test	Result test	Conclusion
1.	Normality test: Kolmogorov-Smirnov	p-value: 0.1842 > 0.05	Significant
2.	Multicollinearity test: correlation coefficient	0,2 : 0,17 : 0,37 < 0.85	Multicollinearity does not occur
3.	Autocorrelation test: Durbin Watson	1.6960 < 1.9254 < 2.3040	there is no autocorrelation
4.	Heteroscedasticity test: Glajser -Test	P value : 0.34, 0.07, 0.31 > 0.05	there is no heteroscedasticity

Based on the results of the classical assumption test, as listed in table 2, it can be concluded that the regression model has met the classical assumptions.

4.2. T- Test

In general, the t-test has the objective of knowing the extent to which the influence of an independent variable individually / partially in explaining the independent variable. In examining this, the researcher used a significance level of 0.05 ($\alpha = 5\%$). Acceptance and rejection of the hypothesis will be proven by following the criteria below:

- a. If the value is prob. $\leq \alpha$ (0.05) and t count > t table, then the hypothesis is accepted.
- b. If the value is prob. $\geq \alpha$ (0.05) and t count < t table, then the hypothesis is rejected.

The t table value at the 0.05 significance level with degrees of freedom (df) is $df = n - k - 1 = 65 - 3 - 1 = 61$, then the t table value is 1.9996. The results of the partial t-test are presented in the following table.

Table 3 T-test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6.670572	1.323195	5.041262	0.0000
Capital Adequacy	0.097864	0.011523	8.492943	0.0000
Non-Performing Financing	-0.378849	0.113615	-3.334486	0.0016
Efficiency	-0.074362	0.012738	-5.837870	0.0000

Source: Output of eviews 9, 2020

In accordance with the table, it can be concluded that the hypothesis in this study is:

1. Hypothesis 1: Capital adequacy has a positive effect on profitability in sharia Banks.

The results of the t-test in table 3 show that if the probability value of the capital adequacy variable <critical probability value ($\alpha = 5\%$) is 0.0000 <0.05 and the t count> t table is 8.4929> 1.9996, this means that capital adequacy influences profitability. The regression coefficient of 0.0979 indicates a positive direction. This means that capital adequacy has a positive effect on profitability at sharia banks in Indonesia. By these statistical results, the first hypothesis proposed by the researcher is accepted.

2. Hypothesis 2: Non-performing financing has a negative effect on profitability in sharia banks.

The t test results in table 3 show that if the probability value of the independent variable financing problems <critical probability value ($\alpha = 5\%$) is 0.0016 <0.05 and t count> t table is 3.3345> 1.9996, it means that the variable financing problem has an influence. on profitability. The regression coefficient of -0.3788 indicates a negative direction. Which means problematic financing has a negative effect on profitability in sharia banks in Indonesia. In accordance with these statistical results, the second hypothesis proposed by the researcher is accepted.

3. Hypothesis 3: Efficiency has a negative effect on profitability in sharia banks

The t-test results in table 3 show that if the probability value of the independent variable efficiency <critical probability value ($\alpha = 5\%$) is 0.0000 <0.05 and t count> t table is 5.8379> 1.9996, this means that the efficiency variable has an effect on profitability variable. The regression coefficient of -0.0744 indicates a negative direction. This means that efficiency has a negative effect on profitability in sharia banks in Indonesia. In accordance with these statistical results, the third hypothesis proposed by the researcher is accepted.

The F test is carried out to prove whether together with all independent variables, namely capital adequacy, problematic financing, and efficiency have an influence on the dependent variable, namely profitability in sharia banks in Indonesia. The test criteria carried out are:

- a) If the probability <5% significance level = 0.05, it means that H_a is accepted, namely capital adequacy, non-performing financing, and efficiency simultaneously / simultaneously have an influence on profitability in sharia banks in Indonesia.
- b) If the probability > 5% significance level = 0.05, it means that H_0 is accepted, namely capital adequacy, non-performing financing and efficiency simultaneously / simultaneously have no effect on profitability in sharia banks in Indonesia.

The results of the F test in this study can be seen in the following table:

Table 4 F-Test

R-squared	0.881744	Meandependentvar	0.948154
Adjusted R-squared	0.845543	S.D. dependentvar	4.858231
S.E. of regression	1.909333	Akaike info criterion	4.341126
Sum squared resid	178.6321	Schwarz criterion	4.876360
Log likelihood	-125.0866	Hannan-Quinn criter.	4.552310
F-statistic	24.35701	Durbin-Watsonstat	1.925418
Prob(F-statistic)	0.000000		

Source: Output of eviews 9, 2020

By the test results in table 4, it can be seen if the probability value of F-statistic is smaller than alpha (0.05), which is $0.000000 < 0.05$, which means the independent variable is the capital adequacy, non-performing financing capital, and efficiency simultaneously has an effect on profitability in sharia banks in Indonesia.

The coefficient of determination (R²) is carried out to determine how much the ability of the independent variable to explain the dependent variable can be seen through adjusted R². The coefficient of determination is zero and one. If the value of R² is small, it means that the ability of the independent variable to explain the variation in the dependent variable is very limited. The results of the coefficient of determination can be seen in Table 5 below:

Table 5 Coefficient of Determination

R-Square	Adjusted-R Square
0.881744	0.845543

Source: Output of eviews 9, 2020

The results of the tests in table 5 show that the value obtained from the coefficient of determination of r square is 0.881744. This study uses three independent variables, so the adjusted R Square value is used to measure the proportion of the effect of the independent variable on the dependent variable. The adjusted r square value is 0.845543, indicating that the proportion of the influence of the independent variable on capital adequacy, non-performing financing, and efficiency on profitability at sharia banks in Indonesia is 84.55 percent, while the remaining 15.45 percent is influenced by other variables not examined by researchers.

5. DISCUSSION

The results of the multiple regression analysis show that capital adequacy has a positive effect on profitability by looking at the regression coefficient of 0.0979 indicating a positive direction. This means that capital adequacy has a positive effect on profitability at sharia banks in Indonesia (H1 accepted). In signal theory, management provides signals to external parties through financial reports. The signal given can be in the form of good news or bad news. Companies that announce high capital adequacy rates show positive signals, causing investors to be interested in investing. Based on signal theory, investors assume that companies that have high enough capital have good confidence to improve their performance in generating profitability. Banks that have high capital can be said to be safer than banks that have low capital, because banks that have large capital must have less need than external funding. If capital adequacy is greater, the bank's capital capacity to protect the possibility of the risk of business loss will also be higher, which means that the bank's performance will also experience an increase (Prasanjaya and Ramantha, 2013). If capital adequacy increases, it means that the bank's ability to become stronger in bearing the risk of any risky credit or productive assets. That way, the higher the bank's capital adequacy in bearing the risk of bad credit, so that later the bank's performance will be better, and also the public will have more confidence in the bank concerned which will lead to an increase in profits. Thus, it can be concluded that capital

adequacy has a significant positive effect on profitability. The results of this study are relevant to previous research conducted by Munir (2018), Mahmuda (2016), and Ma'isyah (2015) which states that the capital adequacy variable has a significant positive effect on financial performance. So it can be concluded that capital adequacy has an influence on profitability.

The results of the multiple linear regression analysis show that non-performing financing have a negative effect on profitability by looking at the regression coefficient of -0.3788 indicating a negative direction. This means that problematic financing has a negative effect on profitability in sharia banks in Indonesia (H2 is accepted). In signal theory, the company discloses the company's financial condition in an annual report. High non-performing financing will give negative signals to investors. This happens because investors think that the company cannot manage financing, so that the company's profitability has decreased. The higher non-performing financing means that the quality of financing product in sharia bank is getting worse. The risk of financing accepted by the bank is one of the bank's business risks, which is caused by not repaying the principal installments and profit sharing from loans issued or investments that the bank is making (Muhammad, 2005: 358). The results of this study are relevant to previous research conducted by Medina (2018), Mahmuda (2016) and Lemiyana (2016) showing the results that problematic financing has a significant negative effect on profitability. So it can be concluded that non-performing financing has a negative effect on profitability.

The results of multiple linear regression analysis show that efficiency harms profitability by looking at the regression coefficient of -0.0744 indicating a negative direction. This means that efficiency harms profitability in sharia banks in Indonesia (H3 accepted). Signal theory explains the existence of information disclosed by companies. The company's financial statements reflect the company's performance in the year concerned. One of the signals given in the company's financial statements is efficiency. High efficiency causes the company not to be optimal in financial performance. Efficiency is the ratio between total operating expenses and total operating income. This comparison is used to measure the level of efficiency and ability of the bank in carrying out its operational activities (Dendawijaya, 2009). If the efficiency is higher, the bank's performance will decrease. Likewise, if the efficiency level is lower, it means that the bank management performance is getting better (Zai and Margaretha, 2013). Thus, the size of the efficiency will affect the profitability of the bank.

The results of this study are relevant to previous research conducted by Lemiyana (2016), Hakiim (2016), and Mawardi (2015) which states that the efficiency variable has a significant negative effect on profitability. So it can be concluded that efficiency has a negative influence on profitability.

6. CONCLUSION

Based on the results of the analysis and research discussion, it can be concluded that Islamic banks have a high ability to earn profits. Meanwhile, the independent variables that affect the profitability of Islamic banks are capital adequacy, financing problems and efficiency. Based on the results of hypothesis testing, it shows that the first hypothesis is accepted, namely that capital adequacy has a significant effect on profitability, meaning that the higher the available capital, the Islamic bank will generate a lot of profits. The second hypothesis which states that efficiency affects the profitability of Islamic banks is accepted. This shows that the more efficient a sharia bank is in managing financing and funding, the higher the productivity of sharia banks. The third hypothesis which states that problematic financing affects the profitability of sharia banks is accepted. This shows that the less problematic financing, the higher the productivity of sharia banks.

The results of this study support the theory of efficient capital structure, although the composition of sharia bank capital comes mostly from externals, because sharia bank management is very efficient in managing funding and financing activities and can manage banks prudently where sharia banks can suppress problematic financing, sharia banks can achieve high profit. This is also supported by the existence of a temporary syirkah fund source of capital that is neither a type of debt nor owner's equity. Temporary syirkah funds are a very efficient source of funds for sharia banks because the bank will reward the owners of temporary syirkah funds only if the bank makes a profit. The opposite applies, if the sharia bank does not gain a profit, aka a loss, then the sharia bank does not provide returns to the owner of temporary syirkah funds. This is the advantage of sharia banks compared to conventional banks. Although based on the determination coefficient test, it shows that the Adjusted R Square value is 0.8455, which indicates that the research model achieves high good fit, the researchers suggest that the next researchers who are interested in developing this research can add several other independent variables such as the structure of sharia financing and sharia governance.

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