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Analysis of Factors Affecting Profitability (Study on Islamic Commercial Banks Registered with the Financial Services Authority in 2018-2022)

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Abstract: This study aims to examine the effect of NPF, FDR, and GCG on the profitability of Islamic commercial banks. The data used is secondary data in the form of annual financial reports from 17 Islamic Commercial Banks in Indonesia registered with the Financial Services Authority for the period 2018-2022 so 69 observation data were obtained. The independent variables used are NPF, FDR, and GCG which are proxied by the number of boards of directors and the frequency of board meetings. At the same time, the dependent variable used is return on assets (ROA). The results of this study indicate that FDR has an effect on the profitability of Islamic commercial banks, while NPF, the board of directors, and the board of commissioners have no significant effect on the profitability of Islamic commercial banks.

Keyword: Profitability, NPF, FDR, and GCG

INTRODUCTION

The economic system cannot be separated from the role of financial institutions, either in raising funds, channeling funds, or both. Based on Law Number 14 of 1967, financial institutions are entities that have activities in the financial sector whose role is to attract money and distribute it to the public. Indonesia is a country where the majority of the population is Muslim, and the community's need for services in accordance with Islamic sharia provisions is also increasing. Therefore, one of the alternative banking services that has become an interesting phenomenon today is the presence of Islamic banks that have provided new nuances in the business world.

The development of Islamic banking can be seen through its total assets. The following is the development of total Islamic banking assets in Indonesia based on data taken from Islamic Banking statistics issued by the Financial Services Authority:

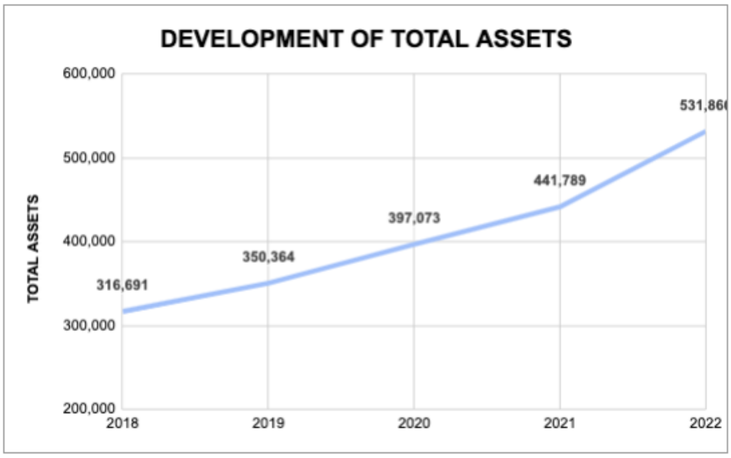

Figure 1. Development of Total Assets
Source: Author's processed data

The figure above shows that the total assets of Islamic banking always increase every year. Even though the growth of Islamic banking assets is high, the market share of Islamic banking is still inferior to conventional banking. According to Anam & Anggraini (2020), the cause of the low market share in Indonesia is due to the low knowledge, understanding, and loyalty of consumers to Islamic banks. In addition, another cause is that the presence of conventional banks was earlier than Islamic banks, so the market share of conventional banks is higher than Islamic banks (Bahri, 2016).

The low market share of Islamic banking is a challenge for Islamic banks. Islamic banks must be able to create stakeholder trust (board of commissioners, board of directors, employees, investors, government, and society) by maintaining their performance to remain in the healthy category. If this trust has been created, then Islamic banking will continue to grow and develop.

Performance is an important thing for banks because trust is the underlying thing in this business scope, the bank must be able to demonstrate its credibility so that more people will transact at the bank. The profitability ratio is one of the most appropriate indicators to measure the financial performance of a company. Islamic banking operating in Indonesia strives to achieve the maximum level of profit because the higher the company's profitability, the better the company's financial performance. One of the ratios used to measure profitability ratio is Return On Asset (ROA).

Profitability can be influenced by several factors, namely asset quality, liquidity, board of directors, and board of commissioners. Measuring tools that can be used as a measure of the factors that affect profitability, namely Non-Performing Financing (NPF), Financing to Deposit Ratio (FDR), and Good Corporate Governance (GCG) (Suwarno & Muthohar, 2018).

The NPF ratio shows the performance of Islamic banking in managing the risk of financing carried out. The results of research by Hakimul'Izza & Utomo (2022), explain that Non-Performing Financing has a negative effect on profitability. This means that when loans experience repayment problems due to causes beyond control, it causes the quality of bank financing to be poor. The following statement contradicts the findings of Purwanti et al. (2022) and Afkar et al. (2020).

FDR shows the ability of banks to channel funds to debtors while paying back depositors by relying on loans as a source of liquidity. A high FDR value causes a higher risk in channeling financing, but if the bank distributes funds in the form of financing, the results that will be obtained by the bank are also high. Meanwhile, if the FDR value is low, it can show that the bank's lack of effectiveness in channeling funds so that bank profits will decrease (Rahmawati, 2021). The results of this study differ from Hakimul'Izza & Utomo (2022) who stated that FDR has no effect on ROA.

Good Corporate Governance applies the principles of transparency, accountability, responsibility, professionalism, and fairness. To ensure the sustainability of these five principles, a GCG mechanism is needed, one of which consists of a board of directors, and a board of commissioners.

The board of directors is one of the most important functions of a company. In the corporate governance structure, board size is an important mechanism in determining company performance (Sukandar & Rahardja, 2014). If the board of directors is increasing, the bank's financial performance will increase (H. Islami et al., 2020). This finding is supported by the results of previous research conducted by (Ben Abdallah & Bahloul, 2021). However, this contradicts the research of Billah & Fianto (2021) which states that the board of directors has no effect on profitability.

The Board of Commissioners has the task of holding meetings to evaluate the policies taken by the Board of Directors. In the Financial Services Authority regulation No.33/ POJK.04/2014, article 31 paragraph 1, states that the board of commissioners is required to hold a meeting at least 1 (one) time in 2 (two) months. The more frequent meetings are expected to be better for supervising the company (Kasandra, 2020). Meanwhile, according to research conducted by AlAdawiyah (2021) and Armansyah & Kusumadewi (2022) state that the board of commissioners meeting variable has a positive and insignificant effect on profitability.

Based on the above phenomena, the authors are interested in conducting research with the title: "Analysis of Factors that Affect the Profitability of Islamic Commercial Banks in Indonesia in 2018-2022".

METHOD

The type of research used is quantitative research. The type of data in this study is secondary data obtained electronically using the documentation data collection method. The research subjects in this study were all Islamic Commercial Banks in Indonesia registered with the OJK. Determination of the subjects in this study was carried out using a purposive sampling technique. Based on the results of purposive sampling, there are 17 Islamic Commercial Banks that match the criteria, so the total research data is 69.

The object of this research is the annual financial statements of Islamic commercial banks registered with the Financial Services Authority (OJK) in 2018-2022. The variables to be examined in this study are profitability proxied by ROA, Asset Quality proxied by NPF, Liquidity proxied by FDR, Board of Directors, and Board of Commissioners.

This research uses the panel data regression analysis method. Panel data is a combination of time-series data and cross-section data. In the analysis process, the author uses the Eviews version 13 program as a data analysis tool. There are several models for estimating regression model parameters from panel data: Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM). The methods used to determine which model is the most appropriate are the Chow Test, Hausman Test, and Lagrange Multiplier Test.

If the chosen approach is CEM and FEM, then a classical assumption test must be carried out consisting of Multicollinearity Test and Heteroscedasticity Test. Then, after all the classical assumption tests are met, a hypothesis test is carried out which consists of the Coefficient of Determination Test (R2) and the t (Partial) Test.

RESULTS AND DISCUSSION

Descriptive Analysis

The following table will explain the statistical description of the dependent variable and the independent variable from the total number of research samples.

Table 1. Descriptive Analysis

	ROA	NPF	FDR	DD	RDK
Mean	0.014148	0.014681	0.932025	4.724638	12.78261
Std. Dev.	0.403949	0.014575	0.705068	1.484073	10.11469
Observations	69	69	69	69	69

Source: Author's processed data

Based on Table 1 above, the average ROA variable is 0.014148 and the standard deviation is 0.040182. This result shows that the standard deviation > average. This means that the data distribution is wide or the data is too extreme. While the NPF, FDR, Board of Directors, and Board of Commissioners variables display a standard deviation value < than the average. This means that these results indicate that the distribution of these variables is in good condition.

Panel Data Regression Model Testing

Chow Test

The Chow test is used to choose whether the Fixed Effect Model is better than the Common Effect Model.

Table 2. Chow Test Results

Redundant Fixed Effects Tests
Equation: Untitled
Test cross-section fixed effects

Effects Test	Statistic	d.f.	Prob.
Cross-section F	5.634562	(16,48)	0.0000
Cross-section Chi-square	72.944087	16	0.0000

Source: Eviews 13 Output Results

The Chow test results show that the Cross-section Chi-square probability value is 0.0000 <0.05. This means that the appropriate panel data regression model to use is the Fixed Effect Model (FEM).

Hausman Test

The Hausman test is used to determine between the Fixed Effect Model or Random Effect Model approach that is most appropriate to use.

Table 3. Hausman Test Results

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	20.369752	4	0.0004

Source: Eviews 13 Output Results

The Hausman test results show that the cross-sectional random probability value is 0.0004 < 0.05. This means that the appropriate panel data regression model to use is the Fixed Effect Model (FEM).

Lagrange Multiplier Test

The Lagrange Multiplier test is conducted to determine which is the most appropriate to use the Random Effect Model or the Common Effect Model in estimating panel data.

Table 4. Lagrange Multiplier Test Results

Lagrange Multiplier Tests for Random Effects
Null hypotheses: No effects
Alternative hypotheses: Two-sided (Breusch-Pagan) and one-sided (all others) alternatives

	Test Hypothesis Cross-section	Time	Both
Breusch-Pagan	15.16837 (0.0001)	0.113843 (0.7358)	15.28221 (0.0001)

Source: Eviews 13 Output Results

The Lagrange Multiplier test results show that the Breusch-Pagan value is 0.0001 < 0.05. This means that the appropriate panel data regression model to use is the Common Effect Model (REM). After running three tests, it can be concluded that the panel data regression model chosen is the Fixed Effect Model (FEM).

Classical Assumption Test

Multicollinearity Test

The multicollinearity test aims to determine whether there is a correlation between the independent variables in the regression model.

Table 5. Multicollinearity Test Results

	DD	FDR	NPF	RDK
DD	1.000000	-0.225224	-0.225354	0.382136
FDR	-0.225224	1.000000	-0.068869	-0.153936
NPF	-0.225354	-0.068869	1.000000	-0.204789
RDK	0.382136	-0.153936	-0.204789	1.000000

Source: Eviews 13 Output Results

Based on the test results shown in the table above, it is known that the coefficient value between variables is smaller than 0.8, which means it is in accordance with the test criteria. So it can be concluded that the data does not have multicollinearity problems.

Heteroscedasticity test

The heteroscedasticity test aims to test whether, in the regression model, there is an inequality of variance from the residuals of one observation to another, if the variance from one observation to another is the same, it is called homoscedasticity. If the variance is different, it is called heteroscedasticity.

Table 5. Heteroscedasticity Test Results

Dependent Variable: ABS_RES
Method: Panel Least Squares
Date: 08/14/24 Time: 22:51
Sample: 2018 2022
Periods included: 5
Cross-sections included: 17
Total panel (unbalanced) observations: 69

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.006007	0.017965	0.334395	0.7395
DD	0.004856	0.003723	1.304147	0.1984
FDR	0.002911	0.004163	0.699185	0.4878
NPF	-0.471853	0.307007	-1.536946	0.1309
RDK	-0.000373	0.000398	-0.936963	0.3535

Source: Eviews 13 Output Results

From the test results in the table above, based on the probability value for each independent variable has a probability value greater than 0.05. So it can be concluded that heteroscedasticity does not occur.

Hypothesis Testing, Results, and Interpretation

Test Coefficient of Determination (Adjusted R^2)

Table 6. Determination Coefficient Test

Cross-section fixed (dummy variables)			
R-squared	0.679597	Mean dependent var	0.014148
Adjusted R-squared	0.546096	S.D. dependent var	0.040182
S.E. of regression	0.027072	Akaike info criterion	-4.134865
Sum squared resid	0.035178	Schwarz criterion	-3.454920
Log likelihood	163.6528	Hannan-Quinn criter.	-3.865108
F-statistic	5.090577	Durbin-Watson stat	1.886821
Prob(F-statistic)	0.000002		

Source: Eviews 13 Output Results

Based on Table 6 the Adjusted R-Squared result is 0.546096. So it is concluded that 54.6096% of the NPF, FDR, Board of Directors, and Board of Commissioners variables can explain the ROA variable. While the remaining 45.3904% is caused by other factors outside of the independent variables in this study.

Partial Test (Statistical Test t)

Table 7. Partial Test Results

Dependent Variable: ROA
Method: Panel Least Squares
Date: 08/14/24 Time: 22:37
Sample: 2018 2022
Periods included: 5
Cross-sections included: 17
Total panel (unbalanced) observations: 69

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.017215	0.028609	0.601739	0.5502
DD	-0.006610	0.005929	-1.114892	0.2704
FDR	0.020678	0.006630	3.118931	0.0031
NPF	0.036548	0.488895	0.074757	0.9407
RDK	0.000654	0.000634	1.031162	0.3076

Source: Eviews 13 Output Results

Based on Table 7, it can be seen that the FRD variable has a positive coefficient value of 0.020678 and a probability value of 0.0031 < 0.05, meaning that FDR has a positive and significant effect on ROA. While the NPF variable, the Board of Directors (DD) and the Board of Commissioners (RDK) have a probability value above 0.05, which means that NPF, DD, and RDK have no significant effect on the ROA variable.

Therefore, based on the table and explanation, an equation is obtained to interpret the results of panel data regression analysis in this study as follows:

$$\mathbf{Y = a + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \mathit{e}}$$

$$\text{ROA} = 0.017215 + 0.036548\ \text{NPF} + 0.020678\ \text{FDR} - 0.006610\ \text{DD} + 0.000654\ \text{RDK} + e$$

Research Discussion Results

The Effect of Asset Quality (NPF) on Profitability (ROA)

Based on the research analysis, asset quality (NPF) has a negative and insignificant effect, this means that there are also aspects where asset quality may not have a significant impact on profitability. For example, in some cases, companies can manage the risks associated with non-productive assets in an effective way through careful risk management strategies. This can involve portfolio diversification or the use of derivative financial instruments to protect the company's financial position from fluctuations in the value of unproductive assets.

The results of this study are in line with the results of research conducted by Purwanti et al. (2022) which states that NPF has a significant positive effect on profitability. However, it is different from the results of research by Hakimul'Izza & Utomo (2022), which explains that NPF has a negative effect on profitability.

The Effect Liquidity FDR on Profitability (ROA)

The test results in this study indicate that Liquidity (FDR) has a positive and significant effect on profitability (ROA), which means that a good FDR ratio will be one of the key factors that can contribute positively and significantly to the profitability of a company. This means that the higher the FDR value, the higher the profitability of Islamic Banks. The higher the FDR shows the use of bank funds to be channeled in the form of greater financing. The greater the financing provided, the greater the margin received (for murabaha contracts), and the profit sharing obtained (for mudharabah and musyarakah contracts), so that the profit earned will be greater.

This research is in line with the theory that states that in measuring liquidity, Islamic banks generally use FDR. FDR states how much of the Third Party Funds of Islamic banks are released for financing. An increase in third-party funds without an increase in financing will reduce the profit received by the bank. So the higher the FDR, the bank's profit will increase. However, the results of this study differ from Hakimul'Izza & Utomo (2022) which state that FDR does not have an influence on profitability variables or FDR has a negative and insignificant effect on profitability.

The Effect of Board of Directors (DD) on Profitability (ROA)

The test results in this study indicate that the Board of Directors (DD) has an insignificant effect on profitability (ROA). The Board of Directors is generally responsible for providing general direction and assessing executive performance, rather than being directly involved in the day-to-day activities that directly affect the profitability of the company. In addition, the effectiveness of the Board of Directors in influencing profitability can also be influenced by the composition and structure of the board itself. In many cases, the board may consist of individuals who may have diverse backgrounds and do not necessarily have an in-depth understanding of daily operations or the specific factors that affect profitability.

The results of this study are in line with the results of research from Fatimah & Rahman (2021) which state that the Board of Directors (DD) has no effect on Profitability (ROA), but the results of this study contradict the results of research from N. Islami, (2018) which states that if the Board of Directors is increasing, profitability performance will increase.

The Effect of the Board of Commissioners (RDK) on Profitability (ROA)

The test results in this study indicate that the Board of Commissioners Meeting (RDK) has an insignificant effect on ROA. The Board of Commissioners has a crucial role in overseeing and advising company management to ensure transparency, accountability, and adherence to good corporate standards. Despite its importance in maintaining integrity and good governance, the BOC does not have a significant impact on company profitability. While the BOC can provide valuable insight and advice, the implementation of operational and tactical strategies remains in the hands of executive management. Therefore, the impact of the BOC on financial aspects such as revenue increases, cost reductions, or operational efficiencies that contribute to company profitability is limited.

The results of this study differ from the results of research by Frumentius & Christiawan (2020) which state that the frequency of Board of commissioners meetings has a positive effect on bank profitability.

CONCLUSION

In this study, the authors analyzed the financial performance of Islamic Commercial Banks in Indonesia in the period 2018-2022 using several factors. The results of the analysis show that partial Financing to Deposit Ratio (FDR) has a positive and significant effect on Return on Asset (ROA), which means that the higher the FDR ratio, the higher the bank's profitability. Conversely, Non-Performing Financing (NPF), Board of Directors (DD), and Board of Commissioners (RDK) have no significant effect on ROA, so the growth of these factors does not affect profitability. The suggestion for the company is to continue channeling funds to customers with the principle of prudence in order to reduce the risk of bad financing and increase profitability. Management through the elected boards also needs to be optimized. For future researchers, it is recommended to explore other variables and update the data period for further research.

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