The Effect Of Islamic Banking Financial Ratio On The Financial Performance

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ABSTRACT

This study explores the impact of Net Operating Margin (NOM), Operating Expenses to Operating Income (BOPO), Non-Performing Financing (NPF), and Capital Adequacy Ratio (CAR) on the financial performance of Islamic banks listed under the Financial Services Authority (OJK) from 2018 to 2023. Using secondary data obtained from financial reports available on the banks' official websites, the study employed a purposive sampling method. The population consisted of Islamic banks registered with OJK during the study period, narrowing down to 6 banks with 36 observations as the final sample. Data analysis utilized multiple linear regression to examine the relationships between the variables, accompanied by hypothesis testing to determine their statistical significance. The findings indicate that NOM and BOPO did not show a significant influence on the financial performance of the sampled Islamic banks. However, NPF and CAR demonstrated a substantial and statistically significant impact. These results underscore the importance of managing credit risk and maintaining adequate capital reserves to ensure financial stability and performance in Islamic banking. This study provides valuable insights for policymakers and bank managers to focus on strengthening risk management practices and capital adequacy to sustain and enhance the financial health of Islamic banking institutions in Indonesia.

1. Introduction

Since its establishment in 1992, Indonesia has experienced a remarkable expansion in the number of Islamic banks and Islamic banking units, showcasing a robust evolution in this sector. Islamic banking offers a fitting choice for individuals looking for a financial system that matches their values. The growth of sharia banks, financial institutions, and the business sector in Indonesia demonstrates the achievement of the sharia economy [1]. The terms “bank” and “sharia” refer to a place that serves as a financial middleman. Since starting in 1992, Indonesia has experienced quick growth in the amount of sharia banks and sharia business units. Sharia banking offers the right option for people who seek financial solutions that fit their beliefs. The increase of sharia banking and financial institutions as well as companies in Indonesia is one way to measure the success of the sharia economy. The phrase “Islamic bank” combines the ideas of two parties: the party with more money and the party lacking sufficient funds. In Indonesian sharia banking, “syariah” means the rules that guide agreements between two parties about managing and funding business activities and other operations according to Islamic law [2].

1.1 Background

The success of a financial institution can be evaluated using various parameters, with financial reports serving as an essential instrument to assess the operational performance of banks. Among these, financial ratios such as Return on Assets (ROA) are frequently utilized to gauge a bank's financial achievements. The following prerequisites must be met for Indonesia's Islamic banking ROA to increase:

Growth of Islamic Banking ROA	
Tahun	**ROA**
2018	1,28%
2019	1,73%
2020	1,40%
2021	1,55%
2022	2,00%
2023	2.08%
Source :*Sharia Banking Statistics, 2018-2023*	

Based on the table above, the Return On Asset (ROA) of Islamic banking increased in 2018-2019 by 0.45 and decreased in 2019-2020 by 0.33%. Then it increased by 0.15% in 2021 to 1.55%. Then in 2022-2023 there will be an increase of up to 2.08%. **.** A reduction in the growth of Return on Assets directly undermines the profitability levels of Islamic Business Banks (BUS), posing challenges to their sustainability.

There was a decrease in ROA to 1.40% in 2020. This downturn is predominantly attributed to the adverse effects of the COVID-19 pandemic, which triggered a substantial decline in revenue generation for numerous businesses across different sectors. After a decline in the previous year, ROA showed a slight recovery to 1.55% in 2021. This recovery can be attributed to the adaptation strategies carried out by Islamic banks in overcoming the economic impact of the pandemic, as well as a gradual increase in economic activities, a significant increase in 2022 and 2023, namely ROA reaching 2.00% and 2.08%, respectively, showing that Islamic banks have succeeded in optimizing their assets and improving operational efficiency.

One of the primary factors influencing the financial outcomes of Islamic banks is the Net Operating Margin (NOM). This ratio represents the comparison between net operational income and the average productive assets, expressed as a percentage, and reflects the management's efficiency in optimizing productive income generation. The magnitude of this ratio can be interpreted as an increase in operational income for productive activities managed by banks so that the possibility of problematic conditions at banks is smaller[3]

Another pivotal determinant is the Operating Expenses to Operating Income (BOPO) ratio, which significantly contributes to the determination of Return on Assets (ROA). This ratio is employed to measure the bank's operational efficiency and its effectiveness in cost management [4].

The Non-Performing Financing (NPF) ratio serves as a crucial indicator, evaluating the bank management's capability to handle non-performing loans effectively and maintain asset quality. A reduction in the NPF ratio is indicative of an enhancement in the financial health and performance of the banking institution. This is because the third party does not have difficulty in paying or returning the borrowed funds when they are due[5].

Capital Adequacy Ratio (CAR) is also a vital measure of financial soundness, assessing a bank's capacity to support risk-laden or income-generating assets while ensuring adequate solvency. CAR indicates the efficiency of capital utilization to sustain operations and mitigate risks [6].

1.2 Problem statement

1. Is there a significant influence of the Net Operating Margin (NOM) on the financial performance of Islamic banks in Indonesia during the 2018–2023 period?
2. How does the Operating Expenses to Operating Income (BOPO) ratio impact the financial To what extent does the Non-Performing Financing (NPF) ratio affect the financial performance of Islamic banking institutions in Indonesia between 2018 and 2023?
3. What is the impact of the Capital Adequacy Ratio (CAR) on the financial performance of Islamic banking institutions in Indonesia throughout 2018 to 2023?

1.3 PurposeandScope

1. This study aims to explore the impact of the Net Operating Margin (NOM) on the financial performance of Islamic banking in Indonesia within the specified period from 2018 to 2023
2. The objective is to evaluate the effect of Operating Expenses to Operating Income (BOPO) on the financial performance of Islamic banking in Indonesia during the same time frame
3. To assess the role of the Non-Performing Financing (NPF) ratio in influencing the financial outcomes of Islamic banks in Indonesia from 2018 to 2023
4. To analyze how the Capital Adequacy Ratio (CAR) shapes the financial performance of Islamic banking institutions in Indonesia during the 2018–2023 period

2. LiteratureReview

Signal Theory

One of the key theories for understanding financial management is signaling theory. The basis of signal theory, also called signaling theory, is the concept that various parties have access to different information. This information-related theory demonstrates the existence of information between the management of the business and information-seeking parties. Because of this, managers must issue financial statements to interested parties in order to enlighten them. [7].

In banking or finance, various key signs are used to indicate the company's well-being and financial success, including Net Operating Margin (NOM), Operating Expenses Operating Income (BOPO), Non-Performing Financing (NPF), and Capital Adequacy Ratio (CAR).

Financial Performance

One of the fundamental theories for grasping financial management is signal theory. Signal theory, commonly referred to as signal theory, examines a company's financial performance to assess how well financial implementation guidelines have been correctly and appropriately applied. Financial performance is also derived from an evaluation of finished work, with outcomes compared to mutually set benchmarks. Every completed task must be evaluated or measured continuously [8].in determining whether the bank can maintain its financial health. This study uses ROA as a reference in measuring bank profitability. This metric is employed to evaluate a bank's proficiency in generating annual pre-tax profits derived from all assets utilized in its operations. The ROA value of a bank can be calculated with the formula:

$$Return\ On\ Asset = \frac{Net\ Profit}{Amount\ Of\ Asset} X\ 100\%$$

Net Operating Margin

INet Operating Income and average productivity are compared using the Net Operating Margin (NOM) ratio, which is shown as a percentage. This ratio measures how well bank management controls productivity in producing the bank's net operating income. A large ratio can be viewed as a growth in operating income from the productive activities overseen by banks.[3]. The amount of NOM value of a bank can be calculated by the formula:

$$NOM = \frac{Net\ Operating\ Income}{AktivaProduktiv} X\ 100\%$$

Operating Expenses Operating Income

The Bank examines the Operating Income (BOPO) ratio to assess operating rates and operating income; a lower BOPO indicates improved performance for the bank, reflecting a more effective use of available resources. Banks need to maintain a BOPO ratio of 93.52%, these assessments align with the stipulations and regulatory requirements established by Bank Indonesia. [4]. The BOPO ratio of a bank is computed using a specific formula that compares operating expenses to operating income, providing insights into operational efficiency:

$$BOPO = \frac{Operating\ Expenses}{Operating\ Income} X\ 100\%$$

Non Performing Financing

The Non-Performing Financing (NPF) ratio is one of the parameters used to gauge a bank's effectiveness in managing the risk associated with non-performing loans. The challenges encountered by banks stem from bad loans or non-performing loan products, along with the growth in loan distribution in the banking sector, as shown by the Indicator of banks' ability to manage the risk of borrower default in the Non-Performing Financing (NPF) ratio. Challenging loan offerings or bad loans also occur because of the greater distribution of loans in the banking system.[5].The amount of NPF value of a bank can be calculated by the formula:

$$\text{NPF} = \frac{Problematic\ Financing\ Income}{Totsl\ Financing} X\ 100\%$$

Capital Adequacy Rasio

A banking efficiency measure known as the Capital Adequacy Ratio (CAR) checks if banks have enough capital to support safe or risky assets. Solvency ratios, or CARs, ensure a bank can run its business using its capital. The capacity of banks to maintain assets that carry or pose risk is assessed using CAR, a gauge of a bank's efficiency [6]. The amount of CAR value of a bank can be calculated by the formula:

$$\text{CAR} = \frac{Capital}{Risk\ Weighted\ Asset} X\ 100$$

2.1 Related Jobs

A notable commonality between this research and prior studies is the focus on Islamic banking as the subject of investigation. However, a key distinction lies in the selection of dependent variables used for analysis. In the previous study, earlier research predominantly analyzed dependent variables such as Capital Adequacy Ratio (CAR), Non-Performing Financing (NPF), Operating Expenses to Operating Income (BOPO), and Financing to Deposit Ratio (FDR), whereas this study prioritizes Net Operating Margin (NOM), BOPO, NPF, and CAR, highlighting variations in approach, namely only Net Operating Margin (NOM). Another difference in previous research, the data used covers the period 2018-2022, while the author's current research uses a newer period, namely 2018-2023. This suggests that the authors' research includes more recent data and may provide a more relevant perspective on the current conditions in the Islamic banking industry.

2.2 Research Gaps

This researcher expanded on previous studies by adding more factors that influence financial performance, the sample selection expanded to encompass all Islamic commercial banks officially registered with the Financial Services Authority (OJK). Previous findings suggest that the Net Operating Margin (NOM) exerts a positive and significant influence on financial performance, contrasting with other studies that assert no correlation. Similarly, variations in findings regarding the influence of BOPO further distinguish this study from earlier research positively and significantly influences financial performance. The study [7] also observes that Non-Performing Financing (NPF) negatively and insignificantly impacts financial performance. This is in contrast to the study of [10], Comparative studies show discrepancies in findings regarding the influence of Non-Performing Financing (NPF) and Capital Adequacy Ratio (CAR) on financial performance, with some indicating significant impacts while others do not.

3. Methodology

3.1 Data Collection

This research employed a documentation methodology, involving the systematic collection, recording, and review of secondary data, including annual reports from Islamic banks and publications from the Financial Services Authority (OJK). as well as from various supporting books, journals of research results and other sources.

3.2 Analysis Techniques

The analytical process utilized in this study included multiple linear regression analysis conducted through SPSS as the primary statistical tool.

3.3 Validation

The outcomes of the t-test indicate that the variable Net Operating Margin has a significance level of 0.910, exceeding the threshold of 0.05. This implies that the Net Operating Margin does not exert any meaningful influence on financial performance. Consequently, the initial hypothesis is not supported. The heteroscedasticity test is meant to assess if there is a difference in variance between residual observations. Typically, good regression relies on normally distributed data.

4. Results and Discussion

4.1 Key findings

The variable representing operating expenses relative to operating income yields a significance value of 0.642, which is greater than 0.05. This finding suggests that the operational cost variable does not significantly affect financial performance. As a result, the second hypothesis is disproven. The variable representing operating expenses relative to operating income yields a significance value of 0.642, which is greater than 0.05. This finding suggests that the operational cost variable does not significantly affect financial performance. As a result, the second hypothesis is disproven. The Non-performing Financing (NPF) variable demonstrates a significance value of exactly 0.05, which is below the 0.05 threshold. This indicates that Non-performing Financing significantly affects financial performance. Hence, the third hypothesis is validated.

The Capital Adequacy Ratio variable is associated with a significance value of 0.002, which is well below 0.05. This confirms that the Capital Adequacy Ratio has a substantial influence on financial performance. Therefore, the fourth hypothesis is corroborated. The R^2 coefficient analysis reveals a value of 0.241 or 24.1%. This percentage suggests that 24.1% of the variability in financial performance can be explained by independent variables, such as Net Operating Margin, operating expenses relative to income, Non-performing Financing, and Capital Adequacy Ratio. The remaining 75.9% is attributable to other variables not included in the research framework.

4.2 Interpretation of Results

The findings indicate that the Net Operating Margin does not significantly impact financial performance, meaning that variations in the Net Operating Margin value do not play a critical role in enhancing or diminishing financial outcomes. This is possible if the bank does not fully rely on income from operating margins, but rather from other sources of income. The operational expenses relative to operating income exhibit no meaningful effect on financial performance, 2023 which means that the efficiency or inefficiency of bank operating costs in generating income does not directly impact financial performance. This may be because banks can recoup high costs from other sources of revenue or have other efficiency strategies in place that reduce the direct impact of BOPO on performance.

Non-performing Financing significantly influences financial performance, implying that fluctuations in the NPF ratio, whether high or low, directly affect economic outcomes. High NPF will pressure financial performance because bad financing or default reduces revenue and increases potential losses. In contrast, low NPFs support good financial performance as banks can maximize revenue from smooth financing. Capital Adequacy Ratio affects financial performance, which means that a high or low capital adequacy ratio will affect financial performance. A high CAR usually supports financial performance because the bank has enough capital to manage risk and maintain stability. Banks with low CAR will be more vulnerable to fluctuations and losses, which ultimately negatively impacts financial performance.

5. Discussion

5.1 Comparison with Previous Research

This research concludes that the Net Operating Margin has no observable impact on financial performance, which contradicts the results of research by [10] that shows Net Operating Margin positively affects financial performance. Operational expenses relative to operating income do not significantly affect financial performance, challenging the findings of prior studies [7] Contrarily, some studies assert that operational expenses relative to income positively and significantly affect financial performance. Non-Performing Financing does affect financial performance, which contradicts the conclusions of research by [7] that asserts Non-Performing Financing does not affect financial performance. The Capital Adequacy Ratio has a demonstrable impact on financial performance, contrary to findings from earlier studies, such as [9], which suggest otherwise.

5.2 *Limitations*

When conducting research, there are several sharia commercial banks that are difficult to access their financial statements on the websites of each sharia commercial bank website.

5.3 Future Research

For the next researcher can add other variables that can affect performance.

6. Conclusion

The study's results show that Net Operating Margin does not influence the financial performance of Islamic banks between 2018 and 2023. Similarly, operational expenses relative to income have no effect, while Non-performing Financing and Capital Adequacy Ratio do influence financial outcomes during the same period.

7. Recommendations

This study examines how financial ratios such as Net Operating Margin (NOM), Operating expenses relative to income (BOPO), Non-performing Financing (NPF), and Capital Adequacy Ratio significantly affect the return on assets (ROA) of Islamic commercial banks in Indonesia from 2018 to 2023. This study aims to identify factors influencing the financial performance of Islamic banking using a quantitative approach, relying on secondary data from annual financial reports. Analytical tools such as multiple linear regression analysis and classical assumption tests, including assessments for multicollinearity, heteroscedasticity, and autocorrelation, are employed.

The results of this study show that the Net Operating Margin and Operating Costs of Operating Income do not affect financial performance. Conversely, Non-performing Financing and Capital Adequacy Ratio exhibit significant effects on financial performance. The Adjusted R^2 value of 0.443 indicates that 44.3% of the variability in ROA can be attributed to the studied independent variables. The t-test results further reveal that the Net Operating Margin variable, with a significance value of 0.910 exceeding 0.05, does not impact financial performance, leading to the rejection of the first hypothesis. Similarly, operational expenses relative to income, with a significance value of 0.642 above 0.05, do not affect financial outcomes, resulting in the rejection of the second hypothesis. On the other hand, Non-performing Financing, with a significance value of 0.05, confirms its influence on financial performance, validating the third hypothesis. The Capital Adequacy Ratio, with a significance value of 0.002 below 0.05, also demonstrates its substantial impact, showing that Operating Costs of Operating Income impact financial performance, resulting in the acceptance of the fourth hypothesis.

Attachment

Table 1 Descriptive Statistics

DescriptiveStatistics

	Mean	Std. Deviation	N
ROA	1.3456	1.20092	36
NOM	1.3231	.99210	36
BOPO	87.6231	24.22940	36
NPF	2.3008	1.15418	36
CAR	23.2786	5.46736	36

Source: Data processed by SPSS v 25

Table 2 normality test

One-SampleKolmogorov-SmirmovTest

		UnstandardizedPredicted Value
N		36
Normal Parameters[a,b]	Mean	1.3455556
	Std. Deviation	.68774037
MostExtreme Difference	Absolute	.089
	Positive	.079
	Negative	-.089
TestStatistic		.089
Asymp. Sig. (2-tailed)		.200[c,d]

a. Testdistributionis Normal
b. CalculatedFrom data.
c. LillieforsSignificanceCorrection
d. Thisis a lowerboundofthetruesignificance
Source: Data processed by SPSS v 25

Table 3 Partial Test
Coefficients

Model		Unstandardizted Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig
1	(Constant)	-2.579	1.412		-1.826	.078
	NOM	-.021	.180	-.017	-.114	.910
	BOPO	-.004	.008	-.073	-.470	.642
	NPF	534	.177	.513	3008	.005
	CAR	131	.038	.595	3450	.002

a. DependentVariable: ROA

Source : Data processed by SPSS v 25

Table 4 Coefficient of Determination
[2] Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Errorofthe Estimate
1	.573b	.328	.241	104609

a. Predictors: (Constant), CAR, NOM,BOPO,NPF
b. DependentVariable: ROA

Source : Data processed by SPSS v 25

Confession

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