



# The Effect of Capital Adequacy, Non-Performing Financing, Efficiency, And Liquidity on Financial Performance in Sharia Commercial Banks in Indonesia

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**ABSTRACT:** This study aims to examine the effect of capital adequacy, non-performing financing, efficiency, and liquidity on the level of financial performance at Islamic Commercial Banks in Indonesia. This study is a population study with the number of companies studied as many as 13 Islamic Commercial Banks in Indonesia during the 2014-2019 observation period so that 75 observations are obtained. This study uses multiple linear analyses of panel data to analyze the data to be studied. This study empirically finds that CAR, NPF, BOPO, and FDR have a negative influence on the financial performance of Islamic banks.

**KEYWORDS:** Capital Adequacy Ratio, Efficiency, Financial Performance, Islamic Banks, Liquidity, Non Performing Financing.

## PRELIMINARY

The development of Islamic banking has grown rapidly after it was empirically proven that Islamic banking was not affected by the financial crisis that hit the world, including Indonesia (Fahlevi, Surtinah, and Firmansyah, 2019). The financial crisis in Indonesia in 1998 had a broad impact on the liquidation of several conventional banks, but this did not happen to Islamic banks. Sharia Banks have proven that the application of Islamic principles in their operational systems can ensure the stability of the value of bank assets and community assets that have been collected. Therefore, Islamic banks were able to survive through the crisis (Mahmudah, 2019).

Since the enactment of Law Number 10 of 1998 and amended by Law Number 21 of 2008 concerning Sharia Banks, banking operational activities in Indonesia are divided into Conventional Banks and Sharia Banks. Conventional Banks carry out all their operational activities conventionally, while Sharia Banks carry out their business activities according to sharia principles. Sharia principles implemented by Islamic banks are based on fatwas issued from an institution authorized to manage Islamic law issues. In Indonesia, this institution is the Indonesian Ulema Council (MUI).

As with conventional banks, the purpose of establishing a sharia bank in Indonesia is to support the development of the national economy to improve justice, cooperation, and equitable distribution of community welfare (Buchory, 2017). In addition, the development of Islamic banking in Indonesia is part of efforts to rehabilitate the banking system to increase the resilience of the national economy (Mahmudah, 2019). Sharia banks tend to be able to survive in all changes in economic conditions, even in times of crisis (Fahlevi et al., 2019).

According to Setyawati et al. (2017), Islamic banks are more able to survive in the face of financial crises than conventional banks because Islamic banks are more committed to assisting the development of micro, small and medium enterprises (SMEs) as their priority market share. Sharia Bank positions itself as a partner for the real sector. In addition, with its ability to survive in a crisis, Sharia Banks emerged as a more just and efficient system, thus making the Islamic financial system grow into a new, more stable force in the current global financial system (Abduh and Omar, 2012 in Setyawati et al., 2017). With these principles and roles, the level of public trust in Islamic banks in Indonesia continues to grow, in addition to Indonesia being the country with the largest Muslim population in the world.

The development of Islamic banking in Indonesia began with the establishment of Bank Muammalat Indonesia on May 1, 1992 (Tristingtyas and Mutaheer, 2013). Until now, the performance of Islamic banking has shown encouraging developments, but it is still not in line with the desired target. Based on Sharia Banking Statistics published by the Financial Services Authority as of November 2019, there were 14 Sharia Commercial Banks, 20 Sharia Business Units, and 164 BPRS with total assets of 507,761 billion Rupiah. This value is still relatively small compared to the total national banking assets of 9,067,160 billion Rupiah. In other



words, the market share of Islamic Banks in Indonesia at the end of 2019 was only 5.6%, even though the government has set a target market share of Islamic Banks of 20% until the end of 2024 (Wijayanti, 2019). This encourages practitioners to look for strategy formulations that can improve the financial performance of the Sharia Banks they manage to achieve the targets set.

The financial performance of a Sharia Bank is a description of the financial condition of a Sharia Bank in a certain period (Tristiningtyas and Mutaher, 2013). Financial performance can be measured using several indicators, including Return On Equity (ROE), Return On Assets (ROA), and Net Profit Margin (NPM). This study uses the ratio of Return On Assets (ROA) to assess the financial performance of Islamic banks. The choice of ROA is because this indicator can describe the extent to which management utilizes the assets owned by the company effectively to create profits. In addition, the ROA indicator can reflect the Bank's ability to earn overall profits (Hakiim and Rafsanjani, 2018). The greater the ROA value indicates better financial performance because management can obtain a rate of return from the utilization of its assets. Performance is one of the main factors that will have a direct impact on the growth of Sharia Bank's market share.

**Table 1.** The growth of Assets and Market Shares of the Islamic Banking in Indonesia

| Year | Total Assets<br>(Billion Rupiahs) |              | Market Share (%) | Growth (%) |
|------|-----------------------------------|--------------|------------------|------------|
|      | National                          | Sharia Banks |                  |            |
| 2014 | 5.615.150                         | 282.394      | 5,03             | 3,34       |
| 2015 | 5.919.390                         | 308.987      | 5,22             | 9,42       |
| 2016 | 6.475.602                         | 372.881      | 5,76             | 20,68      |
| 2017 | 7.099.564                         | 440.305      | 6,20             | 18,08      |
| 2018 | 7.751.621                         | 492.364      | 6,35             | 11,82      |
| 2019 | 8.712.597                         | 524.564      | 6,02             | -5,20      |

Source: The Statistic of Islamic Banking, The Financial Services Authority (2020)

The development of Islamic banks in Indonesia shows the growth of assets and market share which continues to increase from year to year. As presented in Table 1, the average growth of Islamic Bank assets during 2014-2018 was 12.67% while the market share growth achieved by Islamic Banks in Indonesia until 2018 was 6.35%. This shows that the development of assets as reflected in the market share of Sharia Banks in Indonesia is still very low, even though the stability of Sharia Banks in carrying out their operations is based on Islamic principles and public demand for Sharia Bank services in Indonesia is still very high. In addition, the expectations of stakeholders, including the government, are very high on the potential development of Islamic banks in Indonesia. This is as stated in the Syari'ah Banking Roadmap 2014-2019 published by the Financial Services Authority (OJK) which targets the market share of Islamic Banks to be at least 10% above the market share of Conventional Banks by the end of 2019. This shows that Islamic Banks still have huge potential to be able to develop further. In increasing market share, equitable asset growth is needed in all Islamic banking in Indonesia. Asset growth can be achieved by improving the financial performance of Islamic banking. Unfortunately, the average performance of Islamic banking as measured by the ROA ratio is still lower, ranging from 0.63 to 1.12%, compared to the conventional banking performance of 2.35-2.50% (Handayani et al., 2019). The following presents data on financial performance measured using ROA at Islamic Commercial Banks in Table 2.

**Table 2.** The Financial Performance (ROA) of Islamic Commercial Banks in Indonesia

| No | Sharia Commercial Bank | 2017 (%) | 2018 (%) | 2019 (%) |
|----|------------------------|----------|----------|----------|
| 1  | PT. Bank Muammalat     | 0,04     | 0,08     | 0,05     |
| 2  | PT. May Bank Syariah   | 5,50     | -6,86    | 11,15    |
| 3  | PT. BCA Syariah        | 1,2      | 1,2      | 1,2      |
| 4  | PT. BRI Syariah        | 2,38     | 2,50     | 2,47     |
| 5  | PT. Bank Mega Syariah  | 1,56     | 0,93     | 0,89     |



|    |                               |        |      |      |
|----|-------------------------------|--------|------|------|
| 6  | PT. Bank Bukopin Syariah      | 0,02   | 0,02 | 0,04 |
| 7  | PT. Bank BNI Syariah          | 1,31   | 1,42 | 1,82 |
| 8  | PT. Bank BTPN Syariah         | 11,2   | 12,4 | 13,6 |
| 9  | PT. Bank Victoria Syariah     | 0,36   | 0,32 | 0,05 |
| 10 | PT. Bank Jabar Banten Syariah | -5,69  | 0,54 | 0,60 |
| 11 | PT. Bank Mandiri Syariah      | 0,59   | 0,88 | 1,69 |
| 12 | PT. Bank Panin Syariah        | -10,77 | 0,26 | 0,25 |
| 13 | PT. Bank Aceh Syariah         | 2,51   | 2,38 | 2,33 |

Source: Data processed (2020)

Based on Table 2, it can be seen that the level of profitability of assets at Islamic Commercial Banks in Indonesia is still not evenly distributed and has a significant gap. Until 2019, Bank BTPN Syaria'h has the best performance which shows growth every year and achieves the highest level of profitability from asset turnover, which is above 10%. There is a contrasting difference when compared to the majority of other Sharia Commercial Banks which only have a ROA ratio of less than 2.5%. To achieve asset growth and market share as targeted, Sharia Commercial Banks must strive to improve their financial performance so that they continue to increase every year. Many factors can encourage the improvement of the performance of Sharia Commercial Banks, both from the internal and external aspects of the company. This study will examine several internal factors that can affect the performance of Islamic Commercial Banks in Indonesia, namely capital adequacy, non-performing financing, liquidity (Kinanti and Purwohandoko, 2017), and efficiency (Handayani et al., 2019).

Capital adequacy describes the bank's ability to provide capital to create profits (Wibowo and Syaichu, 2013). The increasing value of capital adequacy gives management the freedom to invest their funds in various more profitable financial portfolios. This will have an impact on a greater rate of return as bank income so that it will affect the improvement of financial performance. Several previous studies have not found consistent results. The results of research by Tristingtyas and Mutaher (2013), Mokoagow and Fuady (2015), and Suwarno and Muthohar (2018) show that capital adequacy has a positive and significant effect on bank financial performance. Meanwhile, Rafelia and Ardiyanto (2013) found the opposite, where capital adequacy harmed financial performance. In contrast to previous research, according to Wibowo and Syaichu (2013) and Samail et al. (2018), capital adequacy has no significant effect on the performance of Islamic banks.

In addition to capital adequacy, non-performing financing also affects the financial performance of Islamic Banks as proxied by ROA. Non-performing financing shows the ability of Sharia Bank management in managing non-performing financing to the total financing that has been disbursed (Tristingtyas and Mutaher, 2013). The high value of non-performing financing indicates an increase in uncollectible financing, so that the bank loses income that should be received, and will have an impact on increasing the cost of allowance for write-offs (Rafelia and Ardiyanto, 2013). High non-performing income can interfere with the financial performance of Sharia Banks. Previous research related to the effect of non-performing financing on the performance of Sharia Banks also has not provided consistent findings. Research by Rafelia and Ardiyanto (2013) found that non-performing financing has a positive and significant effect on the financial performance of Sharia Banks. Meanwhile, a study conducted by Buchory (2017) found that non-performing financing harmed financial performance. On the other hand, the findings produced by the research of Wibowo dan Syaichu (2013), Tristingtyas and Mutaher (2013), and Suwarno and Muthohar (2018) show that non-performing financing has no significant effect on the financial performance of Sharia Banks.

Another aspect that can affect financial performance is efficiency. Bank efficiency is an effort to minimize operational risk in a bank. Operational risk occurs due to losses caused by operating costs that are too high on revenue (Fahlevi et al., 2019). Banks that have good financial performance are those that can manage operational costs as efficiently as possible. By reducing operational costs, the level of profit obtained will be greater. Rafelia and Ardiyanto (2013), Tristingtyas and Mutaher (2013), Suwarno and Muthohar (2018) found that bank efficiency measured using the BOPO proxy has a negative and significant effect on the performance of Islamic Commercial Banks in Indonesia.

The last aspect examined in this research is liquidity. Liquidity describes a bank's ability to repay third-party funds belonging to the public by relying on the financing it disburses (Fahlevi et al., 2019). The optimal level of liquidity can have an



impact on the effectiveness of the bank's intermediation function and can increase revenues and profits for banks. Previous research related to the relationship between bank liquidity and the financial performance of Islamic banks found mixed results. Research conducted by Mokoagow and Fuady (2015) found that there is a positive influence between liquidity and financial performance. However, the results of research by Tristingtyas and Mutaheer (2013) found the opposite, the liquidity variable has a negative influence on the financial performance of Islamic Commercial Banks in Indonesia. Meanwhile, research by Arshad and Suppia (2019) found that liquidity has a significant effect on the financial performance of Islamic banks.

Based on this phenomenon, the issue of Islamic banking financial performance is interesting to be studied further. In addition, research related to the determinants of financial performance at Islamic Commercial Banks in Indonesia still has not produced consistent findings. Therefore, this study aims to review the relationship of financial performance at Islamic Commercial Banks in Indonesia and the factors that influence it. This research consists of several parts. The Literature review contains supporting theories in the initial section. A framework that seeks to build this research hypothesis in the next section. The next step is the research methods section that explains the population and data samples and analyses used to test hypotheses, results, and discussion sections containing the results of empirical analysis and findings obtained, as well as the conclusion section which contains a summary of the research and the limitations of this study.

## THEORETICAL BASE

### Islamic Commercial Banks

In general, the bank is a business entity that collects funds from the public and distributes them back to the community. According to Law Number 21 of 2008, Sharia Banks are Banks that carry out their business activities based on Sharia principles, which include Sharia Commercial Banks that provide services in payment traffic) and Sharia People's Financing Banks that do not provide services. services in payment traffic (Law of the Republic of Indonesia Number 21 of 2008 concerning Islamic Banking, 2008). Sharia Banks in their activities have a function as an investment manager for funds collected from fund owners, investors in distributing funds, financial services by collecting and distributing funds according to sharia principles, and social services in the form of *baitul mal* (Kusniningrum and Riduwan, 2016; Rahman and Rochmanika, 2012).

Sharia Bank's business activities are built based on the basic principles of sharia, namely economic relations that are bound by a contract. Contracts carried out at Sharia Banks refer to 5 (five) basic concepts, namely savings, profit-sharing, profit margins, rent, and service fees (Kusniningrum and Riduwan, 2016). From the five basic concepts, several Islamic Bank financial products emerged that were used as a complement to its operational activities.

The history of Sharia Banks in Indonesia was first pioneered by Bank Muamalat Indonesia (BMI), which was established in 1992. The emergence of BMI at that time coincided with the issuance of Law no. 7 of 1992 concerning Banking, one of which is regulated is the principle of profit-sharing in banking operational activities, both in the form of Sharia Commercial Banks and Sharia People's Financing Banks (BPRS). After the 1998 monetary crisis in Indonesia, the development of Sharia Banks grew rapidly, until a special regulation regarding Sharia Banks was drafted as stated in Law no. 21 of 2008 concerning Islamic Banking. Based on Sharia Banking Statistics published by the Financial Services Authority (OJK), to date in Indonesia, there are 14 Sharia Commercial Banks (BUS), 20 Sharia Business Units (UUS), and 165 Sharia People's Financing Banks (BPRS).

Sharia banking has a supervisory system that is not the same as conventional banks. Supervision at Sharia Banks is divided into two aspects, namely the monetary aspect which is directly supervised by Bank Indonesia (BI) based on the principles of compliance and prudential principles as in banking in general, as well as aspects of compliance based on Sharia principles in operational activities that are independently supervised. by the Sharia Supervisory Board. Financing in sharia banking according to Law Number 21 of 2008 is divided into 5 (five) types, namely profit-sharing financing (*mudharabah* and *musharakah*), renting (*ijarah*) or leasing (*ijarah muntahiya bittamlik*) financing, sales-based financing (*murabahah*, *salam*, and *istishna'*), lending-based financing (*qardh*), and service-based leasing (Law of the Republic of Indonesia Number 21 of 2008 concerning Islamic Banking, 2008).

### Financial Performance

In the banking industry, both Islamic and conventional banking, financial performance is an important indicator in determining the company's ability to manage and allocate its resources. Therefore, financial performance becomes a benchmark that



must be achieved by a banking company periodically within a certain time. In addition, financial performance can also be a motivation for employees in achieving company goals and compliance with the company's behavioral standards set to produce the expected actions and performance (Mokoagow and Fuady, 2015). Banking financial performance is the determination of a certain measure that can assess the company's success in generating profits (Sudiyatno and Suroso, 2010). With another meaning, bank performance is a description related to the company's performance or ability to work on the operational activities it carries out. For this reason, it is necessary to measure financial performance to assess the achievements achieved by the company within a certain period. One measurement that is often used in assessing the financial performance of Islamic banking is the Return On Assets (ROA) ratio.

The ROA method is focused on assessing the company's ability to earn profits in the company's operating activities (Kinanti and Purwohandoko, 2017). The greater the ROA value, the higher the financial performance achieved by Sharia Commercial Banks, and the stronger the asset position. For some companies, ROA is very dependent on management policies in making decisions, as are other uncontrollable factors such as inflation and economic growth. Regulators believe that ROA is an appropriate proxy for performance measurement in undistorted banks with large capitalization values (Setyawati et al., 2017). The measure of profitability is used to measure how efficiently the company's use of capital is used by comparing profits with the use of operational capital. Therefore, the amount of profit does not guarantee a healthy company (Kinanti and Purwohandoko, 2017).

## Capital Adequacy

Bank's capital adequacy or termed the Capital Adequacy Ratio (CAR) reflects the bank's ability to provide capital to create profits (Wibowo and Syaichu, 2013). The greater the capital adequacy, the greater the opportunity for the bank to make a profit. With large capital, management has the flexibility to put more capital into various types of profitable investment portfolios. On the other hand, the low capital adequacy was caused by an increase in the capacity of risky assets without being offset by additional bank capital. This will have an impact on reducing the opportunity for banks to invest and in the long term can reduce the level of public confidence in banks. Capital adequacy ratio (CAR) as a solvency ratio is a ratio that shows how far all bank assets that contain risks (financing, investments, securities, claims on other banks) are also financed from capital funds owned by banks in addition to funds that can be collected from other parties (Kusniningrum and Riduwan, 2016). According to Brenton C. Leavitt dalam Mokoagow and Fuady (2015), there are 4 functions of bank capital, namely:

- 1) As a protection for uninsured depositors in the event of bank insolvency and liquidation at any time;
- 2) To absorb potential losses due to financing risk to maintain a high level of public trust;
- 3) To obtain physical advice and fulfill other basic needs in offering bank services;
- 4) As a tool for implementing inappropriate asset expansion control regulations.

Capital adequacy is the provision of own capital that is reserved to manage the risk of potential losses arising from the movement of bank assets, most of which are third-party funds collected from the public (Mokoagow and Fuady, 2015). A high capital adequacy ratio reflects the ability of banks to protect depositors and has an impact on increasing public confidence in banks, thereby increasing ROA. The utilization of third-party funds as bank assets in generating profits must pay attention to the interests of depositors as suppliers of bank capital. Thus, banks must provide sufficient minimum capital to guarantee the interests of third parties.

Based on Bank Indonesia Regulation No. 10/15/PBI/2008, the minimum CAR value that banks must have is 8%. The capital adequacy of a bank is interpreted in the form of higher profitability. This indicates that the higher the invested capital, the higher the bank's profitability.

## Non-Performing Financing

Non-Performing Financing at banks is indicated by the value of the Non-Performing Financing (NPF) ratio which reflects the financing ratio. Non-current financing or NPF is a financial ratio used to measure the ability of bank management in managing non-current financing to the total financing that has been disbursed (Tristiningtyas and Mutaher, 2013). According to Asnaini (2014), NPF is a financing activity where the mudharib (the debtor) cannot fulfill the obligation to return the funds that have been borrowed. The higher the NPF ratio indicates the quality of financing at Islamic Commercial Banks is getting worse. This will lead to the loss of potential revenue receipts from the disbursed financing.





NPF is one indicator of the soundness of Sharia Banks. If the NPF is increasing, then the potential for decreasing the level of profitability is even greater. If this happens, the bank will lose the ability to expand financing which can affect the decline in financing growth. In addition, the high NPF on a large scale will also increase the amount of Allowance for Earning Assets in the Bank (Firmansyah, 2014). In the long term, this can disrupt the bank's capital reserves. Therefore, NPF management is very important. Currently, the maximum NPF ratio allowed by Bank Indonesia is 5% (Mutamimah and Chasanah, 2012).

In Indonesia, based on Bank Indonesia Regulation Number 7/2/PBI/2005, non-current financing is classified into 5 types, namely:

- 1) Current;
- 2) Special Mention;
- 3) Sub Standard;
- 4) Doubtful;
- 5) Loss.

## Efficiency

The efficiency referred to in this study is operational efficiency at Sharia Commercial Banks. To measure the level of efficiency of banks in managing their operations, the BOPO indicator is used (Amelia, 2015; Sudiyatno and Suroso, 2010). The Ratio of Operating Costs to Operating Income (BOPO) is a ratio to assess the ability of bank management to utilize its funds to finance its operational activities to earn income (Effendi et al., 2017). The increasing ratio indicates the lack of ability of bank management in minimizing operational costs and maximizing operating income which can potentially cause losses because banks are less efficient in managing their business (Mokoagow and Fuady, 2015). The lower the BOPO value, the more efficient the bank is in managing its operations (Rafelia and Ardiyanto, 2013).

Operational costs are costs incurred by Islamic banks to carry out their core business activities (such as labor costs, marketing costs, technology costs, and other operational costs). The increasing operational costs will affect the decrease in the value of profit before tax which will have an impact on the lower ROA value. While operating income is the main income of a bank obtained from its core business activities, namely the placement of bank funds in the form of financing and other operating income (Mokoagow and Fuady, 2015). An increase in the value of operating income will have an impact on increasing the value of ROA.

This operational efficiency aims to determine whether the bank's operations are carried out properly as expected by the shareholders (Sudiyatno and Suroso, 2010). Operational efficiency is also used to show whether the bank has used all its production factors effectively and efficiently. Based on Bank Indonesia's monetary regulations, the standard value of BOPO that must be owned by banks ranges from 94-96% (Hakiim and Rafsanjani, 2018).

## Liquidity

Liquidity describes the level of the bank's ability to meet the demand for financing by using its total assets (Tristingtyas and Muter, 2013). The assessment commonly used to measure liquidity in Sharia Commercial Banks is the financing to deposit ratio (FDR). This measurement is carried out to see how much third-party funds in banks are used for financing activities (Mokoagow and Fuady, 2015). FDR has a vital role as an indicator that shows the level of financing expansion carried out by banks, so FDR can also be used to assess the extent to which the bank's intermediation function operates (Hakiim and Rafsanjani, 2018). In general, the higher the FDR value indicates the increasingly worrying condition of bank liquidity, conversely, the lower FDR indicates the bank's lack of effectiveness in disbursing financing.

Bank Indonesia limits the value of FDR to the banking industry in Indonesia as an initial step to maintain the soundness of banks. Based on Bank Indonesia regulation Number 15/7/PBI/2013, a bank is said to be healthy if the Loan to Deposit Ratio (LDR) limit as the FDR limit of a Sharia Bank generally ranges from 78% - 92%. This is done so that the level of bank liquidity is well maintained (Mokoagow and Fuady, 2015). A high FDR value (beyond 100%) is a potential threat to bank liquidity levels.

There is a paradoxical relationship between the level of liquidity and profitability. To achieve high liquidity conditions, large cash reserves are needed, where banks will suppress the rate of financing growth to prevent cash outflows. This will hinder the bank's efforts to make a profit. Conversely, to encourage a high level of profitability, the bank's cash reserves that are budgeted to hold liquidity will be channeled to increase financing, so that the level of liquidity decreases (Fahlevi et al., 2019). The higher



the FDR value, the more funds are channeled to third parties. With a high distribution of third-party funds, the level of bank income also increases so that ROA will also increase (Hakiim and Rafsanjani, 2018).

## Hypothesis Development

### The Effect of Capital Adequacy on Financial Performance

Capital adequacy or what is termed the Capital Adequacy Ratio (CAR) reflects the bank's ability to provide its capital. Capital has a vital role in business development and accommodates the risk of loss (Hakiim and Rafsanjani, 2018). Large capital adequacy will make banks more flexible in choosing to place their funds in various alternative profitable investment portfolios. This also reduces interest costs due to funding if banks use external party capital to invest (Rafelia and Ardiyanto, 2013). The higher the investment value using own capital, the more costs related to funding investment can be reduced, so that more income and profits can be received by the bank. On the other hand, low capital adequacy caused by an increase in the intensity of risk assets that is not balanced with the addition of own capital will have an impact on decreasing bank opportunities to invest and can reduce the level of public confidence (Wibowo and Syaichu, 2013). This will certainly affect the bank's income and profits so that it will potentially reduce the quality of the bank's financial performance. Previous research conducted by Sudiyatno and Suroso (2010), Tristingtyas and Mutaheer (2013), Mokoagow and Fuady (2015), and Handayani et al. (2019) found that the capital adequacy factor has a positive and significant effect on the financial performance of Islamic Commercial Banks in Indonesia.

*H1: Capital Adequacy has a positive effect on Financial Performance at Islamic Commercial Banks in Indonesia in 2014-2019.*

### The Effect of Non-Performing Financing on Financial Performance

Non-performing financing (NPF) is one indicator to assess the quality of financing disbursed by Islamic Banking. NPF also reflects the level of financing risk experienced by Islamic banks. The higher NPF indicates an increase in bad debts in the context of financing so that banks lose the potential income that should be received. In addition, the high level of NPF also has an impact on increasing the cost of allowance for write-offs (Rafelia and Ardiyanto, 2013). This will result in a decrease in bank revenues and profits. In line with this study, several previous studies conducted by Tristingtyas and Mutaheer (2013), and Buchory (2017) found that non-current financing harms the financial performance of Islamic Commercial Banks in Indonesia.

*H2: Non-Performing Financing has a negative effect on Financial Performance at Islamic Commercial Banks in Indonesia in 2014-2019.*

### The Effect of Efficiency on Financial Performance

Bank efficiency is an effort made by banks to minimize operational risk. Operational risk arises from losses caused by an operating cost structure that is too large (Fahlevi et al., 2019). This will affect the level of public confidence in banks, resulting in a decrease in demand for services and products offered by banks. Therefore, the level of efficiency of the bank in its operational activities can affect the bank's income and profits (Mokoagow and Fuady, 2015). The level of bank efficiency is measured using the ratio of Operating Costs to Operating Income (BOPO). The smaller the BOPO value reflects the more efficient the bank in managing its operational activities, thus describing a better management performance (Tristingtyas and Mutaheer, 2013). On the other hand, the higher the BOPO value, the more inefficient the bank's operational management is. This is because the costs charged to operations are greater than the income earned by the bank. The greater operational costs will have an impact on the decline in profits so that it will also reduce the quality of the bank's financial performance. Previous research related to bank efficiency found that BOPO had a negative and significant effect on the performance of Islamic Commercial Banks in Indonesia (Sudiyatno and Suroso, 2010; Rafelia and Ardiyanto, 2013; Tristingtyas and Mutaheer, 2013; Hakiim and Rafsanjani, 2018; Handayani et al., 2019).

*H3: Efficiency has a negative effect on Financial Performance at Islamic Commercial Banks in Indonesia in 2014-2019.*

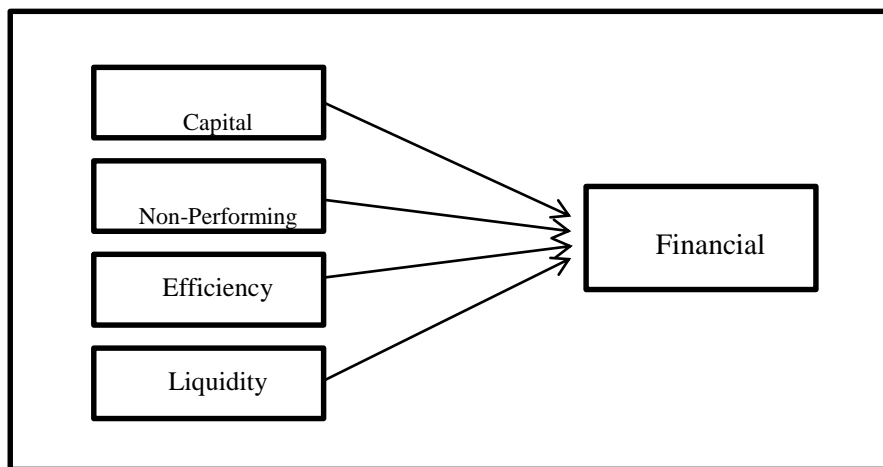
### The Effect of Liquidity on Financial Performance

Liquidity reflects the bank's ability in terms of providing funds to debtors that come from third-party funds it has (Riyadi and Yulianto, 2014). Liquidity at Sharia Commercial Banks is measured using the financing to deposit ratio (FDR) proxy. The FDR value that is too high indicates the low liquidity of a Sharia Commercial Bank. This is because the amount of funds needed to finance financing is getting bigger (Mokoagow and Fuady, 2015). On the other hand, an FDR value that is too low indicates the ineffectiveness of bank management in terms of financing. Therefore, bank management must be able to manage funds, both collected and channeled, optimally.



The optimal FDR value can maintain the bank's intermediation function for the better and increase the bank's income and profits. According to Mokoagow and Fuady (2015), the higher the FDR value within a certain limit, the higher the income and profit, assuming the bank distributes financing effectively. This will have an impact on better financial performance at Sharia Commercial Banks. Previous research was conducted by Sudiyatno and Suroso (2010), Rafelia and Ardiyanto (2013), Mokoagow and Fuady (2015), and Kinanti and Purwohandoko (2017) found that there was a positive influence between liquidity and financial performance at Islamic Commercial Banks in Indonesia. Indonesia.

*H4: Liquidity has a positive effect on Financial Performance at Islamic Commercial Banks in Indonesia in 2014-2019.*



**RESEARCH METHODS**

**Population and Sample**

The population in this study were all Sharia Commercial Banks operating in Indonesia during 2014-2019. The total population of this study is 13 Sharia Commercial Banks that have been operating in Indonesia. Meanwhile, another Sharia Commercial Bank in Indonesia, namely PT. BPD Nusa Tenggara Barat Syariah was not included in the population in this study because the company had just been established outside the observation period of this study, which is on September 24, 2018. The list of sample companies is presented in table 3 as follows:

**Table 3.** The List of Population Company

| No.                      | Company Name                  | Observation |
|--------------------------|-------------------------------|-------------|
| 1                        | PT. Bank Muamalat Indonesia   | 6           |
| 2                        | PT. Maybank Syariah           | 6           |
| 3                        | PT. BCA Syariah               | 6           |
| 4                        | PT. BRI Syariah               | 6           |
| 5                        | PT. Bank Mega Syariah         | 6           |
| 6                        | PT. Bank Bukopin Syariah      | 6           |
| 7                        | PT. Bank BNI Syariah          | 6           |
| 8                        | PT. Bank BTPN Syariah         | 6           |
| 9                        | PT. Bank Victoria Syariah     | 6           |
| 10                       | PT. Bank Jabar Banten Syariah | 6           |
| 11                       | PT. Bank Mandiri Syariah      | 6           |
| 12                       | PT. Bank Panin Syariah        | 6           |
| 13                       | PT. Bank Aceh                 | 3           |
| <b>TOTAL OBSERVATION</b> |                               | <b>75</b>   |





This study uses the population as research data. From the population companies, there are 12 Sharia Commercial Banks which are divided into 6 observation periods, while 1 other Sharia Commercial Bank, namely Bank Aceh Syari'ah has only been converted to Sharia since September 19, 2017, so the number of objects in this study is 75 observations.

## Operationalization of Variables

### Financial performance

Financial performance is the determination of certain measures that can measure the success of a company in generating profits (Sudiyatno and Suroso, 2010). To measure the financial performance of Islamic banks, this study uses Return on Assets (Tristingtyas and Mutaher, 2013). The ROA measurement formula is as follows:

$$ROA = \frac{\sum \text{Earnings Before Tax}}{\sum \text{Assets}} \times 100\%$$

### Capital Adequacy

Capital adequacy or also called capital adequacy ratio (CAR) is an indicator of the ability of Islamic banks to provide funds to support assets that contain potential risk of loss (Sudiyatno and Suroso, 2010). The higher the CAR value, the better the Islamic Bank in managing capital for its financing activities. CAR can be calculated by the following formula (Tristingtyas and Mutaher, 2013):

$$CAR = \frac{\text{Total of Bank's Capital}}{\text{Risk Weight Assets}} \times 100\%$$

### Non-Performing Financing

Non-performing financing (NPF) indicates the risk of financing at Sharia Commercial Banks. NPF is a comparison between the total non-performing financing and the total financing provided. The formula for measuring NPF is as follows (Tristingtyas and Mutaher, 2013):

$$NPF = \frac{\sum \text{Impairment financing}}{\sum \text{Total financing Distributed}} \times 100\%$$

### Efficiency

Efficiency is an indicator that shows the ability of the Bank's management in controlling operational costs to its operating income (Mokoagow and Fuady, 2015). In the banking industry, efficiency is measured using the BOPO ratio (Sudiyatno and Suroso, 2010). BOPO ratio compares between Operating Expenses and Operating Income. The BOPO measurement formula is as follows:

$$BOPO = \frac{\sum \text{Operational Expenses}}{\sum \text{Operational Revenue}} \times 100\%$$

### Liquidity

The liquidity ratio or often called the financing to deposit ratio (FDR) represents the bank's ability to meet its short-term obligations immediately (Kusniningrum and Riduwan, 2016). FDR is measured using a comparison between the amount of financing to third parties and the number of funds raised from third parties (Choirudin, 2017; Kusniningrum dan Riduwan, 2016). The formula for calculating FDR is as follows:

$$FDR = \frac{\text{Total Financing}}{\text{Total Third - Party Funds}} \times 100\%$$

## Analysis Method

This research uses secondary data. This data is obtained from financial reports downloaded from the websites of each company or on the official website of the Financial Services Authority ([www.ojk.go.id](http://www.ojk.go.id)). The method of analysis in this study uses multiple regression analysis with unbalanced panel data to test the variables studied. This analysis aims to examine the effect of CAR, NPF, BOPO, and FDR on ROA at Islamic Commercial Banks in Indonesia during the 2014-2019 observation period. The regression model used in this study is as follows:



$$ROA_{i,t} = \alpha_0 + \beta_1 CAR_{i,t} + \beta_2 NPF_{i,t} + \beta_3 BOPO_{i,t} + \beta_4 FDR_{i,t} + \epsilon$$

Where,  $ROA_{i,t}$  is the financial performance of company  $i$  in period  $t$ ,  $CAR_{i,t}$  is the value of the Capital Adequacy Ratio of the company  $i$  in period  $t$ ,  $NPF_{i,t}$  is the value of the Non-Performing Financing ratio of the company  $i$  in period  $t$ ,  $BOPO_{i,t}$  is the ratio value Operating Costs to Operating Income of the company  $i$  in period  $t$ ,  $FDR_{i,t}$  is the value of the Financing to Deposit Ratio of the company  $i$  in period  $t$ , and  $\epsilon$  is the error term.

**RESEARCH RESULTS**

**Descriptive Statistics**

Descriptive statistics present a description of the characteristics of each of the variables studied. The descriptive statistics of the variables are presented in Table 4.

**Table 4.** Descriptive Statistics

|  | ROA   | CAR   | NPF  | BOPO   | FDR    |
|--|-------|-------|------|--------|--------|
| Unbalanced Panel Data period 2015 - 2019 |       |       |      |        |        |
| Minimum                                  | -2,69 | 11,51 | 0,01 | 58,10  | 22,60  |
| Maximum                                  | 5,15  | 75,83 | 7,11 | 199,97 | 157,77 |
| Mean                                     | 0,78  | 21,90 | 2,67 | 94,17  | 89,31  |
| Std. Dev.                                | 1,38  | 10,54 | 1,86 | 17,06  | 15,55  |
| Observation                              | 75    | 75    | 75   | 75     | 75     |

Table 4 presents descriptive statistics for all tested variables. ROA is financial performance as measured by the percentage value of ROA at each bank. CAR is capital adequacy as measured by the value of the Capital Adequacy Ratio in each Bank. NPF is the level of non-performing financing as measured by the percentage value of NPF in each bank. BOPO is efficiency measured using the value of the BOPO ratio in each bank. FDR is the Financing to Deposit Ratio as measured by the FDR value at each Bank.

Table 4 describes the descriptive statistics of the ROA variable as the dependent variable along with the independent variables used in this study, namely CAR, NPF, BOPO, and FDR. The average ROA value at Islamic Commercial Banks in Indonesia is 0.78 with a minimum value of -2.69 and a maximum value of 5.15. The first independent variable is CAR, the average value of CAR at Islamic Commercial Banks in Indonesia is 21.90 with a minimum value of 11.51 and a maximum value of 75.83. The second independent variable is NPF at Sharia Commercial Banks in Indonesia with an average value of 2.67 with a minimum value of 0.01 and a maximum value of 7.11. The third independent variable is BOPO, the average value of BOPO at Islamic Commercial Banks in Indonesia is 94.17 with a minimum value of 58.10 and a maximum value of 199.97. The last independent variable is FDR which has an average value of 89.31 with a minimum value of 22.60 and a maximum value of 157.77.

**Result of Regression**

This study aims to test the hypothesis by using multiple regression analysis. Before the regression analysis, the data in this study were confirmed to be in the BLUE (Best, Linear, Unbiased Estimator) condition through a series of classical assumption tests. Based on the model suitability test, the data were tested using multiple regression analysis through the Fixed-Effects model approach. The regression results are presented in Table 5.



**Table 5.** The Result of Regression

| Variabel               | Indonesia     |              |        |
|------------------------|---------------|--------------|--------|
|                        | Expected Sign | Koefisien    | Prob.  |
| CAR                    | ( - )         | -0,010896    | 0,6784 |
| NPF                    | ( - )         | -0,514115*** | 0,0000 |
| BOPO                   | ( - )         | -0,018004**  | 0,0447 |
| FDR                    | ( - )         | -0,009433    | 0,4508 |
| C                      |               | 4,923824     | 0,0083 |
| Observations           |               | 75           |        |
| Determination R-Square |               | 0,564907     |        |
| Prob(F-statistic)      |               | 0,000006     |        |

This table presents the results of multiple linear regression to examine the effect of CAR, NPF, BOPO, and FDR on ROA. CAR is the Capital Adequacy Ratio measured using the CAR value at each Bank, NPF is Non-Performing Financing measured using the NPF value at each Bank, BOPO is the ratio of Operating Costs to Operating Income measured using the BOPO value for each Bank, FDR is the Financing to Deposit Ratio which is measured using the FDR value at each Bank.

The results of the regression on Sharia Commercial Banks in Indonesia are:

$$ROA_{it} = 4,9238 - 0,0109CAR_{it} - 0,5141NPF_{it} - 0,0180BOPO_{it} - 0,0094FDR_{it} + \varepsilon_{it}$$

**Note:** \*\*\* shows a significance level of 1%

\*\* shows a significance level of 5%

Based on the results of statistical testing of the regression model in Table 5, the CAR variable has a regression coefficient value of -0.0109. This shows that CAR has a negative influence on the financial performance of Islamic Commercial Banks in Indonesia during 2014-2019. The results of this study are not in line with the theory and research conducted by Mokoagow and Fuady (2015) and Handayani et al. (2019) which found that capital adequacy has a positive effect on financial performance of Islamic Commercial Banks in Indonesia. On the other hand, the results of this study are supported by Tangngisalu et al. (2020) where capital adequacy has a negative effect on financial performance. The factor that causes capital adequacy to have a negative effect is that Islamic Commercial Banks in Indonesia tend to be very careful in distributing financing. Thus, the value of the risk-weighted asset is relatively low. Meanwhile, on the other hand, Islamic Commercial Banks in Indonesia is aggressively raising funds as the main component of their capital. So it is natural that the value of capital adequacy has a negative effect on Return on Assets, because even though the capital owned by banks is high, public confidence is still low, and this will have a negative impact on bank profitability (Tangngisalu et al., 2020). The results of this study reject the first hypothesis.

The NPF variable has a regression coefficient of -0.5141. This shows that the NPF variable has a negative influence on the financial performance of Islamic Commercial Banks in Indonesia during 2014-2019. The results of this study are in line with the research of Tristingtyas and Mutaher (2013) and Buchory (2017) who found that the NPF variable had a negative effect on the financial performance of Islamic Commercial Banks in Indonesia. Non-performing financing can hinder bank operations in obtaining profits. The high level of NPF will tend to increase bank costs, both the cost of reserves for productive assets and other costs (Tristingtyas dan Mutaher, 2013). On the other hand, profitability was hampered due to uncollected financing. Therefore, the higher the NPF level, the lower the bank's financial performance which is assessed using ROA. The results of this study support the second hypothesis.

The BOPO variable has a regression coefficient of -0.0180. This shows that the efficiency variable proxied by BOPO has a negative influence on the financial performance of Islamic Commercial Banks in Indonesia during 2014-2019. The results of this study are in line with the theory in this study and previous research conducted by Tristingtyas and Mutaher (2013), Hakiim and Rafsanjani (2018), and Handayani et al. (2019) which results in the finding that the BOPO variable has a negative effect on the financial performance of Islamic Commercial Banks in Indonesia. The smaller the BOPO value indicates that the performance of



bank management is getting better in managing its operational activities efficiently (Tristiningtyas and Mutaheer, 2013). On the other hand, the higher the BOPO value, the more inefficient the bank's operational management is. This is because the costs charged to operations are greater than the income earned by the bank. The greater the operational costs will have an impact on the decline in profits, so it will affect the quality of the bank's financial performance. The results of this study support the third hypothesis.

The FDR variable has a regression coefficient of -0.0094. This shows that the FDR variable has a negative influence on the financial performance of Islamic Commercial Banks in Indonesia during 2014-2019. The results of this study contradict the theory and are not in line with the research of Sudiyatno and Suroso (2010), Rafelia and Ardiyanto (2013), Mokoagow and Fuady (2015), and Kinanti and Purwohandoko (2017) who found that the FDR variable had a positive effect on financial performance in Islamic Commercial Banks in Indonesia. However, the results of this study are in line with Tristiningtyas and Mutaheer (2013) and Parisi (2017) who found that FDR had a negative effect on financial performance. The higher the FDR value, the lower the liquidity ability of the bank concerned so that the possibility of a bank in troubled conditions will be greater, so that financial performance decreases. Tristiningtyas and Mutaheer (2013). In addition, the results of this study found that FDR had a negative effect on ROA allegedly because Islamic Commercial Banks experienced the risk of substandard financing by their customers (Parisi, 2017). The results of this study reject the fourth hypothesis.

## CONCLUSION

The results of this study found that there was an influence between the independent variables, namely capital adequacy, level of non-performing financing, efficiency, and liquidity on the dependent variable, namely the financial performance of Sharia Commercial Banks in Indonesia. All tested independent variables have a negative effect on financial performance.

Sharia Commercial Banks in Indonesia generally have adequate levels of capital adequacy and liquidity, however, Sharia Commercial Banks currently tend to be very careful in disbursing financing (Tangngisalu et al., 2020), this can reduce the rate of the Bank's financial performance. On the other hand, the relatively high level of non-current financing and the level of efficiency are the main factors in significantly hampering the financial performance of Sharia Commercial Banks in Indonesia.

This study also has several limitations that can be considered for future research developments. Some important limitations in this study include: (1) The sample of this study is limited to Sharia Commercial Banks in Indonesia only. With a relatively small number of sample companies and a relatively short observation period (6 years), the sample obtained is still relatively lacking, so it is possible to affect the accuracy of the research results. (2) This study only analyzes a number of internal factors, while there are other external factors that are thought to influence the level of NPF at Sharia Commercial Banks.

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Cite this Article: M. Rizki Ananda, Aliamin, Ratna Mulyany (2023). *The Effect of Capital Adequacy, Non-Performing Financing, Efficiency, And Liquidity on Financial Performance in Sharia Commercial Banks in Indonesia*. *International Journal of Current Science Research and Review*, 6(12), 7943-7955