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The Effect of BOPO, NPF, and CAR on Profitability in Indonesian Sharia BankingListed on the Financial Service Authority

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Abstract:- This research aims to analyze and empirically prove the effect of Operating Expenses to Operating Income (BOPO), Non-Performing Financing (NPF), and Capital Adequacy Ratio (CAR) on Profitability in Sharia banking of Indonesia listed on the Financial Service Authority during the period 2014-2018. The method used in this research is quantitative method of causality. The data used is sourced from secondary data. The population in this study is all Sharia banking in Indonesia. Sampling techniques in this study used census samples. Based on the predetermined sampling method, the number of samples is12 samples of Sharia banking in the period 2014-2018. Analyze and process data using Microsoft Excel and Eviews 10. The results of the study showed that: 1) BOPO has a negative and significant effect on profitability, 2) NPF negatively and significantly affects profitability, 3) CAR has a positive and significant effect on profitability.

Keywords:- *Operating Expenses to Operating Income, Non-Performing Financing, Capital Adequacy Ratio, Profitability.*

I. INTRODUCTION

The presence of Sharia banking in Indonesia has been almost 3 decades from the beginning of the establishment of the first Sharia bank, namely Bank Muamalat (1991) but the development is still relatively slow. The slow development of Sharia banking is estimated due to market share which is considered still small compared to other Muslim-majority countries in which currently the market share is only about 5.7% (www.republika.co.id,2018).

More clearly, here is a table of developments in Sharia banking assets that affect the market share. This data is taken from The Indonesian Sharia Financial Development Report 2018

Table 1. Development of Sharia Banking Assets for period 2014-2018 (in trillions of rupiah)

Bank	2014	2015	2016	2017	2018
BUS	204.96	213.42	254.18	288.03	316.69
UUS	67.38	82.84	102.32	136.15	160.64
BPRS	6.57	7.74	9.16	10.84	12.36
TOTAL	278.91	304.00	365.66	435.02	489.69

From the table of Sharia Banking asset development above, Sharia banking asset growth table can be made in percentage (%) annually as follows:

Bank	2014	2015	2016	2017	2018
BUS	13.50	4.13	19.10	13.31	9.95
UUS	9.21	22.94	23.52	33.07	17.98
BPRS	12.68	17.74	18.32	18.38	14.03
TOTAL	12.42	8.99	20.28	18.97	12.57

Table 2. Growth of Sharia Banking Assets in 2014-2018 period (in %)

Sharia banking assets in 2018 experienced a slowdown compared to the previous year. In the last three years, the growth of Sharia banking assets is still double-digit with a share of assets of 5.96% to national banks (data from December 2018). This value increased compared to the first half of 2018 with a market share of 5.7% and a previous year of 5.78%.

Several OJK strategy programs in the Indonesia Sharia Banking Roadmap 2015-2019 in encouraging sharia banking improvement are through increasing capital and business scale, improving efficiency through optimization of parent roles, developing Sharia banking services, and increasing sharia banking financing capacity.

The improvement of sharia banking can only be optimized for the retail and consumer sectors that offer relatively limited margins, as reflected by the relatively high BOPO ratio and relatively low ROA compared to conventional banking. Portfolio expansion in the retail segment, especially MSMEs, is also constrained by the relatively limited number and location of outlets, while the expansion into the commercial and corporate segments in addition to capital constraints, is also quite risky due to adverse selection due to the inefficiency of the fund structure, in addition to the limited experience and ability to manage risks in the segment in question that is no longer limited to credit risk.

Based on the statement of Chairman of the Board of Commissioners of the Deposit Insurance Corporation (LPS) Halim Alamsyah on CNBC, sharia banking performance in the last 5 years has slowed down but the performance of each bank is uneven. Some are nice, mediocre and some are even alarming.

At the end of March 2019, the NPF ratio was 3.44% while the conventional banking NPL was 2.5%. in the previous period, sharia banking problematic financing was even greater. As in 2017, the NPF ratio reached 4.76% and 2016 4.42%.

This affects the profitability of Sharia banking, which was recorded at only Rp. 5.12 trillion in 2018. With an asset level of 316.691 trillion and a return on assets (ROA) of only 1.28%. while conventional banking ROA reached 2.55% in December 2018. Sharia banking has always been in the spotlight, especially on issues of capital strengthening, liquidity, and efficiency. From the data in March 2019, the capital adequacy ratio (CAR) of Sharia banking is 19.85%. while conventional banking at 23.42% of this condition illustrates that Shariabanking has not been able to compete with conventional banks. (www.cnbcindonesia.com, 2019).

According to Fahmi (2014:54), profitability ratio aims to show the company's success in making a profit. Profitability also provides a level of effective management performance in a company indicated by the profit generated from sales or revenue. Profitability is inseparable from the relationship between sales, the increase in total assets, as well as the capital itself.

Here aresome research conducted related to Profitability. Aditya Nanda et all (2018) research results illustrate the results stating that BOPO has a positive and significant effect on ROA.While Peling&Sedana research (2018) shows that BOPO negatively affects ROA. Munir's research (2018) stated that NPF has a positive effect on ROA. While Almunawwaroh&Marliana (2017) stated that NPF negatively affects ROA. Bernardin (2016) stated that CAR did not affect ROA. The research conducted by Riyanto (2018), mentioned that CAR has a positive effect on ROA.

Based on the description of the phenomenon, data processing tables, and Sharia Banking Statistics as well as research gaps of previous researches. Thus, this study makes the title "The Effect of BOPO, NPF, and CAR on Profitability (Empirical Study on Sharia Bankinglisted on the Financial Service Authorityduring the period 2014-2018).

II. LITERATURE REVIEW

- *Resources Based Theory*

Wernerfelt (1984) explained that given Resource-Based Theory the company will excel in business competition and get good financial performance by owning, controlling, and utilizing important strategic assets (tangible assets and intangible assets).

Kuryanto (2008) stated that competitive difficulty is generated from the company's ability to manage its resources well so that it can create value-added for the company. The resources in question such as intellectual capital are human capital, structure capital, and consumer capital. Competitive advantages will be created if intellectual capital can be managed properly to grow the performance of the company which ultimately affects the value-added or value of the company.

- *Sharia Accounting Theory*

According to Triyuwono&Gaffikin (1996), Sharia accounting is one of the efforts to deconstruct modern accounting into a humanist and value-laden form. The purpose of the creation of a business civilization with humanist, emancipatory, transcendental, and theological insights. The ontological consequence of this effort is that the accountant critically must be able to free man from the bonds of the reality of civilization, along with its power networks, then provide or create an alternative reality with a set of divine power networks that bind man in everyday life (Tawhid Ontology).

In this way, the alternative reality is expected to be able to raise a full awareness of one's obedience and submission to the power of God. With this self-awareness, he will always feel the presence of God in the dimension of time and place where he is. Sharia accounting should reflect mercy to the universe (*rahmatanlil' alamin*) as following study of accounting in terms of social orientation and accountability's accounting.

According to Gambling & Karim (1986) Socially oriented accounting is accounting that presents or reveals the social impact of the company on society. Thus, the disclosure of the company about its social impact on society as a social obligation.

Based on verse 282 surah Al-Baqarah there is an order from God to maintain justice and truth in doing every transaction. Furthermore, this order emphasizes the importance of accountability so that the parties involved in the transaction are not harmed, do not cause conflict, and remain fair.

- *Return on Asset (ROA)*

According to Danupranata (2016:158), Profitability Ratio is a ratio used to measure the level of productivity of bank businesses reviewed in terms of capital productivity, managed assets, financing, and others.

According to Kasmir (2017:198), There are several benefits that companies can get by measuring profitability ratios. Like; can be known the amount of profit obtained by the company in one period, can know the profit over time, can know the amount of profit after tax with its capital, can know the productivity of all corporate funds used both loan capital and own capital and several other benefits can be obtained by knowing the profitability of the company.

Several indicators can be used to measure profitability. Such as Gross Profit Margin, Net Profit Margin, Operating Profit Margin, Return On Assets, Return On Equity, Return On Investment, Earning Per Share. In this study Return on Assets (ROA) was selected as an indicator of profitability measurement.

Generally, the size or ratio that is often used to measure financial performance is and Return On Asset (ROA). Return On Asset (ROA) focuses on the company's ability to earn money in its operations.

According to Muhamad (2016:431), Return on Assets (ROA) is an overview of bank productivity in managing funds to generate profits described by the Formula:

$$Return\ on\ Asset = \frac{Profit}{Total\ Asset}$$

➢ *Operating Expenses to Operating Income*

According to the Indonesian Bankers Association or IBI (2014:247), BOPO is a bank efficiency ratio that measures operating expenses to operating income. The higher the *BOPO* value eats the more inefficient the bank's operations.

BOPO is also often termed the Operating Efficiency Ratio (REO) This ratio is a cost-to-revenue ratio measured by taking total operating expenses to operating income. This ratio shows how efficiently companies use assets, revenue, and costs. In other words, this ratio shows how well companies are at reducing costs and increasing productivity. (Widagdo and Ika, 2008).

Banks with a high BOPO ratio indicate that the bank does not operate efficiently due to the high operational costs that must be incurred by the bank to obtain operating income. Besides, a large number of operating costs will reduce the amount of profit to be obtained, because the cost or operating expenses act as a factor to reduce the reported profit and loss. Under Bank Indonesia Regulation, the formula used to calculate operating expenses to operating income is as a result of:

$$BOPO = \frac{Operating\ Ekspense}{Operating\ Income} X100\%$$

➢ *Non Performing Financing (NPF)*

Non-Performing Finance (NPF) is the same as Non-Performing Loan (NPL) or non-performing loans. Non-Performing Financing (NPF) terms for Sharia banking and Non-Performing Loan (NPL) terms in conventional banking. Non-Performing Financing (NPF) is one of the risks of the company due to the financial uncertainty of the debtor to pay his obligations.

According to the Indonesian Bankers Association or IBI (2014:254), Non-Performing Loan or Non-Performing Financing is a non-performing credit consisting of credit that is classified classification of substandard,doubtful and loss. By Bank Indonesia Regulation, Non-Performing Financing (NPF) can be calculated by the formula:

$$NPF = \frac{Financing\ (SS,D,L)}{Total\ Financing} X100\%$$

In the formula above, the type of financing SS is Substandar, D is Doubtful and L is Loss. The scope of financing components and financing collectibility is based on the provisions of Bank Indonesia concerning The Quality Assessment of Assets of Commercial Banks Conducting Business Activities based on applicable Sharia Principles.

The purpose of calculating this ratio is to measure the level of financing problems faced by banks. The higher this ratio, indicates the worse the quality of Sharia bank financing. Conversely, the smaller non-performing financing, the less financing risk is borne by the bank.

➢ *Capital adequacy ratio (CAR)*

According to Fahmi (2015:153), capital adequacy ratio (CAR) is one way of measuring the ability of banks to finance their activities with their capital holdings. In other words, the capital adequacy ratio is the performance ratio of banks to measure the adequacy of capital owned by banks to support assets containing or generating risks.

According to Kasmir (2014:46), CAR is a comparison between the ratio of capital to Risk-Weighted Assets in accordance with the provisions set by the government. This ratio can be formulated as follows:

$$CAR = \frac{\text{Capital}}{\text{Risk Weighted Assets}} X100\%$$

From the formula above, the capital in question is the core capital and complementary capital. Assets are weighted according to risks such as credit risk, market risk, and operational risk. The higher the capital, the higher the CAR ratio and the better the company absorbs the risk. In order to improve the bank's ability to absorb risks, it is necessary to increase the quality and quantity of bank capital. Based on Attachment to Bank Indonesia Circular Letter Number 13/24/DPNP 25 October 2011, here are the criteria for rating CAR Ratio assessment.

According to Bank Indonesia Regulation Number 15/12/PBI/2013 Article 2 No. 3 Provision of minimum capital in accordance with the risk profile is determined 8% of Risk-Weighted Assets (RWA) for Banks with a risk profile ranked 1.

➢ *Framework*

The financial performance of Sharia banks can be assessed from their financial ratios such as the ratio of operating expenses to operating income (BOPO), Non-Performing Financing (NPF), and Capital Adequacy Ratio (CAR). If the ratio of BOPO and NPF is small, while the CAR ratio is high then it is likely that the company has a high ROA. Efforts to get maximum profit are made by reducing the ratio of BOPO and NPF and increasing the CAR ratio.

Here's an overview of the relationship between variable X and Variable Y. where BOPO is (X1), NPF (X2), CAR (X3) and Profitability The following is an overview of the relationship between variable X and Variable Y. where BOPO is (X1), NPF (X2), CAR (X3) and Profitability are proxied with ROA (Y)

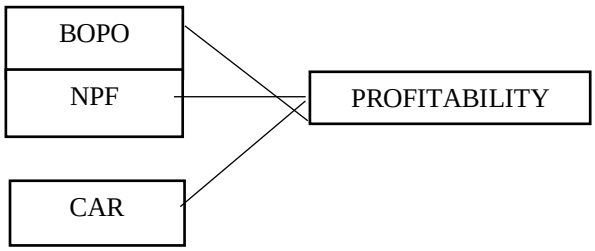

Figure 2.1 Research Framework

III. RESEARCH METHODS

➢ *Type of Research*

This research is quantitative research with a causality research design. The data that is the source of this research is secondary data from financial statements published in the Financial Services Authority.

➢ *Population and Sample*

The population in this study is all 12 Sharia Banking that have been listed during the period 2014 to 2018 and have made financial statements published in the Financial Services Authorization agency. Sampling techniques are carried out using census sample methods.

➢ *Hypothesis Development*

The purpose of this research is to prove that BOPO, NPF, and CAR affect profitability. Here's a hypothetical formulation that will prove to be true:
-BOPO has a significant impact on Profitability
-NPF has a significant impact on Profitability
-CAR has a significant effect on profitability

➢ *Hypothesis Testing*

In this research, hypothesis testing was taken from $t_{statistic}$ from Eviews 10 output results, after which it was compared with t_{table} at a level of significance of 5%. If the value of t_{count} greater than the value of the t_{table} then the hypothesis is accepted and if t_{count} is smaller than the t_{table} then the hypothesis is rejected.

IV. RESULTS

➢ *Descriptive Statistic Analysis*

Table 1. Descriptive Statistics

	ROA	BOPO	NPF	CAR
Mean	0.223167	100.9880	2.645667	24.67983
Median	0.550000	94.72000	2.780000	19.24500
Maximum	12.37000	217.4400	4.970000	163.0700
Minimum	-20.13000	62.36000	0.000000	11.51000
Std. Dev.	4.607494	28.93807	1.680644	21.57792
Observations	60	60	60	60

Source: Output of Eviews

The average value of each variable during 5 years of observation is as follows; Return on assets (ROA) of 0.223167%. Operating Expenses to Operating Income (BOPO) 100.9880%. Non-Performing Financing (NPF) of 2.645667% and Capital Adequacy Ratio (CAR) 24.67983%.

Estimation of Panel Data Regression Model

There are three approaches to the data panel regression model, namely Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM).

The CEM model can be seen in table 2, the FEM model can be seen in table 3, and the REM model in table 4.

Table 2. Common Effect Model (CEM)

Dependent Variable: ROA
Method: Panel Least Squares
Date: 01/29/20 Time: 22:15
Sample: 2014 2018
Periods included: 5
Cross-sections included: 12
Total panel (balanced) observations: 60

Variable	Coefficient	Std. Error	t-Statistic	Prob.
BOPO	-0.001291	0.000126	-10.27054	0.0000
NPF	-0.550128	0.214435	-2.565477	0.0130
CAR	0.000216	0.000167	1.295559	0.2004
C	14.18345	1.056511	13.42480	0.0000

R-squared	0.778780	Mean dependent var	0.223167
Adjusted R-squared	0.766929	S.D. dependent var	4.607494
S.E. of regression	2.224379	Akaike info criterion	4.501173
Sum squared resid	277.0803	Schwarz criterion	4.640796
Log likelihood	-131.0352	Hannan-Quinn criter.	4.555787
F-statistic	65.71395	Durbin-Watson stat	1.075931
Prob(F-statistic)	0.000000		

Source: Output of Eviews

Table 3. Fixed Effect Model (FEM)

Dependent Variable: ROA
Method: Panel Least Squares
Date: 01/29/20 Time: 22:23
Sample: 2014 2018
Periods included: 5
Cross-sections included: 12
Total panel (balanced) observations: 60

Variable	Coefficient	Std. Error	t-Statistic	Prob.
BOPO	-0.001230	0.000103	-11.96190	0.0000
NPF	-0.375769	0.260881	-1.440386	0.1567
CAR	0.000635	0.000197	3.222718	0.0024
C	12.07646	1.142078	10.57411	0.0000

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.898232	Mean dependent var	0.223167
Adjusted R-squared	0.866571	S.D. dependent var	4.607494
S.E. of regression	1.683022	Akaike info criterion	4.091377
Sum squared resid	127.4653	Schwarz criterion	4.614963
Log likelihood	-107.7413	Hannan-Quinn criter.	4.296180
F-statistic	28.37021	Durbin-Watson stat	2.303977
Prob(F-statistic)	0.000000		

Source: Output of Eviews

Table 4. Random Effect Model (REM)

Dependent Variable: ROA
Method: Panel EGLS (Cross-section random effects)
Date: 01/29/20 Time: 22:26
Sample: 2014 2018
Periods included: 5
Cross-sections included: 12
Total panel (balanced) observations: 60
Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
BOPO	-0.001246	0.000101	-12.31599	0.0000
NPF	-0.479576	0.224924	-2.132173	0.0374
CAR	0.000454	0.000171	2.657788	0.0102
C	12.95277	1.104425	11.72807	0.0000

Effects Specification

	S.D.	Rho
Cross-section random	1.545263	0.4574
Idiosyncratic random	1.683022	0.5426

Weighted Statistics

R-squared	0.794941	Mean dependent var	0.097724
Adjusted R-squared	0.783956	S.D. dependent var	3.661225
S.E. of regression	1.701757	Sum squared resid	162.1746
F-statistic	72.36423	Durbin-Watson stat	1.782272
Prob(F-statistic)	0.000000		

Unweighted Statistics

R-squared	0.764004	Mean dependent var	0.223167
Sum squared resid	295.5876	Durbin-Watson stat	0.977847

Source: Output of Eviews

Selection of Panel Data Regression Model

There are three tests that need to be done in the selection of panel data models, namely Chow Test, Hausman Test, and Lagrange Multiplier.

Chow Test

Chow test conducted to select estimation model between CEM and FEM

Table 5. Chow Test

Effects Test	*Statistic*	*d.f.*	*Prob.*
Cross-section F	4.801786	(11.45)	0.0001
Cross-section Chi-square	46.58779	11	0.0000

Chi-Square cross section probability value of chow test result obtained by 0.0000 (prob<0.05), so it can be concluded that in this study fixed effect model is more appropriate compared to common effect model.

Hausman Test

Hausman test conducted to select estimation model between REM and FEM.

Table 6. Hausman Test

Test Summary	*Chi-Sq. Statistic*	*Chi-Sq. d.f.*	*Prob.*
Cross-section random	4.253674	3	0.2353

The probability value of the cross section random of hausman test results is greater than 0.05 (prob> 0.05) which is 0.2353. The value shows that in this study random effect model is more appropriate compared to fixed effect model.

Lagrange Multiplier Test

Lagrange Multiplier test is performed to select estimation model between REM and CEM.

Table 7. Lagrange Multiplier Test

Null (no rand. effect) Alternative	*Cross-section*	*Time*	*Both*
Breusch-Pagan	14.00896 (0.0002)	1.87493 (0.2970)	15.09645 (0.0001)

The Value of Breusch Pagan (BP) in lagrange multiplier test is 0.00002, which means that BP value is less than 0.05, so it can be concluded that random effect model is the most appropriate in this reseach.

From the results of model selection based on regression estimation model test conducted, then the model used in panel data regression in this study is Random Effect Model. With the following equation

ROA = 12.953277 - 0.001246 BOPO – 0.479576 NPF + 0.000454 CAR

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V. DISCUSSIONS

The Effect of BOPO on ROA

Based on the results of the regression analysis random effect model obtained $t_{count} > t_{table}$ is -12.31599 > 2.00 and has a prob-value. (p-value) 0 < 0.05, then the hypothesis is accepted which means, BOPO has a significant influence on ROA. The value of influence is -12.31599, where the value indicates a negative influence. If the value of BOPO decreases, then profitability (ROA) will increase.

BOPO describes management's ability in cost efficiency, especially operational costs to generate maximum operating income.Thegreater the income and the smaller the expenses, so the profit will be higher.

BOPO is a comparison between Operating Expense and Operating Income, the lower the BOPO ratio means the better the performance of bank management because it is more efficient in using existing resources in the company. This is because the bank able to generate a good operating profit. (Rivai, dkk, 2013:480)

The results of this reseach are in line With SimatupangdanFranzlay research (2016)Which states that BOPO has a significant effect on profitability-ROA. Another research that is in line with the results of this study is the research of Javaid&Alalawi (2018) which states that BOPO negatively affects ROA.

The Effect of NPF's on profitability-ROA

Based on the results of random effect regression analysis model obtained $t_{count} > t_{table}$ namely -2.132173 > 2.00 and has a prob value. (p-value) 0.0374 < 0.05, then the hypothesis is accepted which means, NPF has a significant effect on ROA. The value of effect is -2.132173, where the value indicates a negative effect. This means that, if the NPF value decreases Profitability (ROA) will be increase.

NPF is reflection of the risk of financing problematic in sharia banking. The higher the NPF, the worse the quality of Sharia bank financing, and it affects profit. This study corroborates Kasmir statement, (2015:126) that increasing bad loans will result in a decrease in bank profits.

The results of this reseachare in favour of Almunawwaroh's research (2017) that of NPF affects ROA negatively, further, another research which is in line with these research's results is Sanderson & Leroux (2016) that states NPL influences ROA negatively.

The effect of CAR on Profitability

Based on the results of random effect regression analysis model obtained t-count > t-table is 2.657788 > 2.00 and has a prob-value. (p-value) 0.0102< 0.05, then the hypothesis is accepted which means CAR has a significant influence on ROA. CAR variables have a Positive effect on Profitability (ROA). The effect value is 2.657788 where the value indicates a positive effect. This means that if the value of CAR increases, then profitability (ROA) will increase.

CAR is a picture of capital adequacy that banks have toreducethe possibility of risk. Management of capital adequacy will affect the company's profit. The higher the CAR, the more liquid the asset and the more controlled the risk.

According to Dendawijaya (2005:119), capital adequacy is used as an indicator of a bank's health. Strong capital able to maintain public trust in the bank concerned so that the public believes to deposit funds. The funds collected are then re-channelled by the bank to the community in the form of financing. This financing can drive revenue from profit share, from this profit or profit share.

The results of this study support Ananda's research (2016) that car variables have a positive effect on profitability (ROA). In addition, the results of this study also agree with the results of research supporting Maryam et all (2017) which states that CAR has a significant effect on profitability-ROA.

VI. CONCLUSIONS, LIMITATIONS, AND CONTRIBUTIONS TO PRACTICE

Based on BOPO research, NPF and CAR on Profitability can be concluded that Operating Expenses to Operating Income (BOPO) have a negative and significant effect on profitability-ROA in Sharia banks in Indonesia. This indicates that a high BOPO will lower operating profit and affect ROA-Profitability.

Non-Performing Financing (NPF) has a negative and significant effect on ROA-profitability in Sharia banks in Indonesia. This indicates the higher the NPF it will disrupt the capital turnover which affects the decrease in Profitability-ROA.

Capital Adequacy Ratio (CAR) has a positive and significant impact on ROA-profitability in Sharia banks in Indonesia. This proves that the higher the CAR owned, the more optimal the banking development will directly affect profitability-ROA.

This research is expected to contribute to Sharia banking to improve BOPO efficiency as an effort to increase the company's operating profit, establish a market to minimize financing risks, and increase capital to maximize the company's development.

Furthermore, researchers can conduct research not only on sharia commercial banks but all Sharia banks, or the entire Islamic financial industry.

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