

## The Effect of Bank Soundness Factors on Sharia Bank Performance in Indonesia

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### ABSTRACT

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This study examines the impact of bank soundness factors on the performance of Sharia banks in Indonesia using the Risk, Good Corporate Governance (GCG), Earning, Capital (RGEC) approach. The data analysis technique used is a multiple linear regression analysis test, with the hypothesis test used as the t-test and the F-test. The population of this study is all Sharia commercial banks in Indonesia listed in OJK during the 2017-2022 period. The sample used in this study is selected using a purposive sampling method. The study concludes that Good Corporate Governance, Return on Equity (ROE), and Operating Costs to Operating Income (BOPO) have a significant impact on Sharia Bank performance that is proxied by net income or loss. Furthermore, all RGEC variables simultaneously affect bank performance, explaining half of the impact.

*Keywords: Sharia bank, RGEC, Bank Soundness, Bank Performance*

### INTRODUCTION

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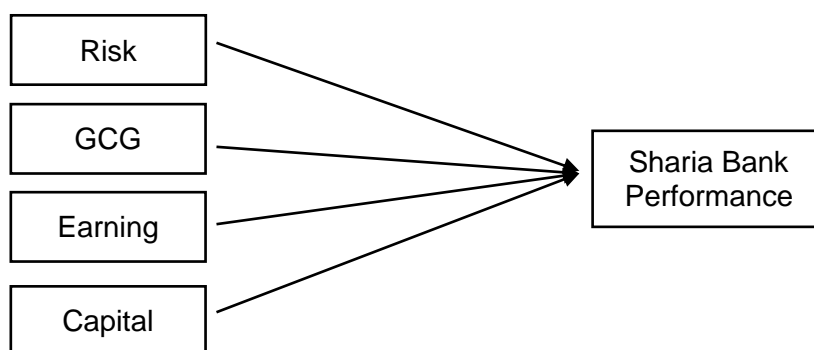
Banking has an essential role in a country. According to Levine 1999, banks, as an indicator of financial development, affect economic growth through several channels. Bank as an intermediary institution, channeling funds from customers through savings into credit. A bank is an institution that acts as a financial intermediary between parties who have funds and those who need funds, as well as an institution that regulates the payment system (Yuda et. al 2010). especially in developing countries, banks have a very important role in society by providing capital to entrepreneurs (Beck & De La Torre, 2007).

In the banking industry, customer trust is very important. Banks are also highly regulated institutions. Banking regulators have various ways to ensure that banks have good performance and can maintain their liquidity. Since 1997 Indonesia's central bank known as Bank Indonesia, has rules for calculating the soundness level of a bank. The method used to measure a bank's soundness level is the CAMELS method. However, since 2011, Bank Indonesia (BI) has changed the method of measuring bank performance to RGEC. This method is expected to be more effective for measuring the soundness of a bank by considering the elements of risk profile, Good Corporate Governance (GCG), earnings, and capital. The results of the assessment of the soundness level of the bank must be reported two times each year. Based on the soundness level of the bank, the bank is categorized into five ratings, namely rating 1, rating 2, rating 3, rating 4, and rating 5. A smaller order of factor ratings reflects a better condition of the Bank (Peraturan Bank Indonesia Nomor 13/1/PBI/2011).

Indonesia is a country that uses a dual-banking system. Currently, 14 Islamic banks and 20 Sharia business units (UUS) operate in Indonesia (Insight KNKS, 2020). Indonesia is

also a country that has the most followers of Islam in the world. The number of Muslim people reached over 236 million people (86 percent) in 2021 (Indonesia Statistic Bureau, 2021). To strengthen the role of Islamic banking in Indonesia, the government issued Islamic Banking Law No. 21/2008 to encourage Islamic windows of conventional banks to become a legal entity separate from their parent company commonly called a spin-off. Currently, 3 Indonesian Islamic banks (formerly known as Bank Mandiri Syariah, BNI Syariah, and BRI Syariah) have merged into one bank called Bank Syariah Indonesia. In line with Yusgiantoro, Soedarmono, and Tarazi (2019) found that the greater a bank's market power, the lower the bank risk and the more stable the financial system. However, Trinugroho et al. (2021) found that the spin-off of Indonesian Sharia banks does not lead to better performance even after four years. The merger of these banks gives strength to the market share of Islamic banks in Indonesia. It increases competition among its competitors, so the soundness level of the bank is one of the factors that must be considered in choosing a bank.

Figure 1. Research Model



This study aims to determine the effect of a bank's soundness level on its performance. Arguably, the healthier a bank should be, it tends to have greater trust from the public, which ultimately affects its income and market share.

### Sharia Commercial Bank Performance

Generally, bank performance is a description of the achievements of a bank in conducting its business activities (Soares and Yunanto, 2018). The distinctive feature of Sharia banking is that it is based on the principle of profit sharing which prioritizes aspects of fairness in transactions so that the basis for profit-taking is different from conventional banks which originate from interest. In this study performance of Sharia Commercial Bank is measured by the net profit/loss that is disclosed in the annual report.

### Risk Profile

Banks are institutions that are prone to risk, so a soundness bank is a bank that can manage its risks well. Based on regulation in Indonesia, the guidelines for implementing Risk Management for Sharia banks are prepared by POJK No. 8/POJK/03/2014 and SEOJK No. 10/ SEOJK.03/2014. At least ten (10) types of risks must be managed: Credit Risk, Market Risk, Liquidity Risk, Operational Risk, Legal Risk, Strategic Risk, Compliance Risk, Reputation Risk, Yield Risk, and Investment Risk. However, this study will focus on credit risk or financing risk in Sharia banks and liquidity risk due to data availability.

Non-performing financing (NPF) is a ratio that represent the level of non-performing financing in a Sharia bank and also show bank management's ability to manage financing risk (Alifedrin and Hermansyah, 2023). While in terms of liquidity can be assessed from Financing to Deposit Ratio (FDR). Even though banks provide financing to the public, a healthy bank must be able to return the funds needed by those who deposit their funds (Akbar, 2018). According to Ifan (2023), NPF and FDR have a significant impact on the

profitability of Sharia Commercial Banks, but FDR has a positive effect while NPF has a negative effect.

H1: NPF has a significant effect on the net profit/loss of Sharia Banks

H2: FDR has a significant effect on the net profit/loss of Sharia Banks

### **Good Corporate Governance (GCG)**

The adoption of GCG practices enhances the transparency of the company's operations, ensures accountability, and improves the firm's profitability (Adebayo, et al, 2014). In addition, Markonah and Prasetyo (2022) revealed that GCG has positive indirect impacts on bank financial performance as well as reflected by total assets increase. Nevertheless, implementing GCG is one of the efforts to protect stakeholders' interests and improve compliance with laws and regulations applicable and generally accepted ethical values.

On the other hand, GCG practices in Sharia Banks must comply with Sharia principles. Bank Indonesia Regulation No. 11/33/PBI/2009 dated December 7, 2009, concerning the implementation of Good Corporate Governance for Sharia Commercial Banks and Sharia Business Units. This regulation is conducted for the Bank's GCG self-assessment semiannually and the results are visible from the rankings 1 to 5, which a smaller index number means better GCG implementation. Research by Devi, Tri, and Ralina (2020) found that GCG has a significant and negative effect on Sharia bank financial performance, interpreting a better GCG index will increase profitability.

H3: GCG has a significant effect on the net profit/loss of Sharia Banks

### **Earning**

High profitability does not mean the bank works efficiently. Efficiency can be known by comparing the profits earned with wealth or capital that generates profits, or by calculating profitability. In this study earning or profitability is measured by three ratios: Return on Asset (ROA), Return on Equity (ROE), and Operating Costs to Operating Income (BOPO). ROA illustrates how much results banks get from financial resources invested in banks (Tilawah and Amalia, 2021). According to Hadiwidjaja, Irma, and Widiastuti (2016), ROA has a significant and positive impact on Bank performance, if ROA increases then profits will grow faster.

ROE is a key profitability ratio investors use to measure the amount of a company's income that is returned as shareholders' equity. ROE constitutes a good proxy for the risk exposures of a bank and its vulnerability to crises (Moussu and Petit-Romec, 2014). Based on Ramlan and Adnan (2016) ROE is a significant factor that influences Sharia Bank profitability.

In addition, one of the ratios OJK and BI used in measuring the banking efficiency level is the BOPO ratio. Companies use the BOPO ratio to measure management's ability to manage operating costs to operating income. Yusuf and Surjaatmadja (2018) found that BOPO has a significant and negative effect on Sharia Bank profitability, which means the increase in Bank operating costs will decrease Bank profit.

H4: ROA has a significant effect on the net profit/loss of Sharia Banks

H5: ROE has a significant effect on the net profit/loss of Sharia Banks

H6: BOPO has a significant effect on the net profit/loss of Sharia Banks

### **Capital**

Indonesian bank regulation no. 13/1/PBI/2011 Article 7 paragraph 2 as referred to in Article 6d includes adequacy level assessment capital and capital management. This regulation states that banks should link capital with bank risk, if the risk is greater than big capital should be provided to anticipate risks (Akhyar, 2018). Capital Adequacy Ratio (CAR) is a tool to measure a bank's ability to maintain its capital and measure management's ability to

control, identify, and monitor the risks that will arise in the amount of bank capital (Alifedrin and Hermansyah, 2023). It is the most important factor for the banking sector because capitalization represents the resilience to face risks and uncertainty of investment in the banking sector (Supiyadi, and Nugraha, 2018). Besides, according to Yusuf and Surjaatmadja (2018), CAR has a significant and positive effect on the financial performance of Sharia Bank.

H7: CAR has a significant effect on the net profit/loss of Sharia Banks

## METHODS

Based on its characteristics, this research is included in quantitative research by processing secondary data and then analyzed by a statistical program to obtain data and results to answer the existing problem formulation. In this quantitative study, the method used is the correlational method which will analyze the correlation or influence between the health factors of Islamic banks as measured by the RGEC method (Risk Profile, Good Corporate Governance, Earnings, Capital) on the net profit of Sharia Commercial Banks in Indonesia during 2017 - 2022.

The population of this study is all Sharia commercial banks in Indonesia listed in OJK during the 2017-2022 period. The sample used in this study was selected using a purposive sampling method with the following criteria.

Table 1. Sample Criteria

No	Criteria	Not Suitable	Total
1.	Sharia commercial banks listed in OJK during 2017-2022	0	14
2.	Sharia commercial bank consistency listed during 2017-2022	(3)	11
3.	Sharia commercial bank has complete data	(2)	9
<b>Total Sharia Commercial Banks sampled</b>			9
<b>Total data sampled (9 banks x 6 years)</b>			54

Source: *Processed data, 2023*

The data analysis technique used is a multiple linear regression analysis test, with the hypothesis test used as the t-test (partial) and the F-test (simultaneous). Before the regression analysis test, a prerequisite test is carried out which is called the classical assumption test, namely by testing data normality, multicollinearity, heteroscedasticity, and autocorrelation. Furthermore, to determine the extent to which the model's ability to explain the variation of the independent variables is able to clarify the dependent variable, a coefficient of determination test (R<sup>2</sup>) is performed.

## RESULT AND DISCUSSION

Testing the classical assumptions shows this research is free from the classical assumption problems. The first classic assumption test, namely the normality test using the Kolmogorov-Smirnov test, shows a sig (2-tailed) value of 0.141 > 0.05, so the data is normally distributed. In the second test, namely the multicollinearity test, all variables show a Tolerance value of > 0.10 and a VIF value of <10 so that it can be concluded that there are no symptoms of multicollinearity. Furthermore, the third test on the classical assumption, namely the heteroscedasticity test which was analyzed using the Glejser test, showed that all variables had a significance value of > 0.05, which means that there was no heteroscedasticity. Finally, the autocorrelation test using the Durbin-Watson test yields a value of 0.1912 with a value of  $du = 1.8632$  which is in the criteria  $du < d < 4 - du$ , which means that this research is free from autocorrelation problems. Thus this study fulfills all the provisions of the classical assumption test so that it can be continued for hypothesis testing. More details regarding the results of the classical assumption test are summarized in Table 2 below.

Table 2. Summary of Classical Assumption Test Results

Test Type	Statistic Test	Value	Explanation
Normality test	Kolmogorov-Smirnov	0,141	Normal distributed data
Multicollinearity test	Tolerance	NPF 0,622	Multicollinearity does not occur
		FDR 0,810	
		GCG 0,544	
		ROA 0,785	
		ROE 0,546	
		BOPO 0,394	
		CAR 0,500	
	VIF	NPF 1,608	
		FDR 1,235	
		GCG 1,837	
		ROA 1,274	
		ROE 1,831	
		BOPO 2,540	
CAR 1,999			
Heteroscedasticity test	Glejser	NPF 0,051	Heteroscedasticity does not occur
		FDR 0,648	
		GCG 0,318	
		ROA 0,136	
		ROE 0,125	
		BOPO 0,737	
		CAR 0,227	
Autocorrelation test	Durbin Watson	1,912	Autocorrelation does not occur

Source : Processed data, 2023

## Determination Coefficient Test (R<sup>2</sup>)

Table 3. Determination Coefficient Test Result

Test Type	Adj R Square
R <sup>2</sup> test	0,507

Source: Processed data, 2023

Based on Table 5, it can be seen that the R square value is 0.507 which means that the independent variables which include NPF, FDR, GCG, ROA, ROE, BOPO, and CAR can explain their effect on the net profit/loss of Sharia Commercial Banks. in Indonesia for the 2017-2022 period of 50.7% while the remaining 49.3% of the net profit/loss of Sharia Commercial Banks in Indonesia for the 2017-2022 period is explained by other variables outside the research.

## Hypothesis Test Results

### t-Test

Table 4. t-Test Results

Variable	t value	Sig.
NPF	0,199	0,843
FDR	-0,849	0,400
GCG	-2,282	0,027
ROA	0,954	0,345
ROE	3,589	0,001
BOPO	-2,116	0,040
CAR	1,274	0,209

Source: Processed data, 2023

The partial results of hypothesis testing proxied by the t-test show that the significance level of the independent variables Good Corporate Governance (GCG), Return on Equity (ROE), and Operating Expenses Operating Income (BOPO) has a value of less than 0.05. This indicates that the third hypothesis (H3), fifth hypothesis (H5), and sixth hypothesis (H6) are accepted, which means that GCG, ROE, and BOPO affect the net profit/loss of Sharia Commercial Banks in Indonesia for the 2017-2022 period. While ROA shows a positive impact, BOPO and GCG have a negative effect on net profit/loss.

Results that show GCG has a significant and negative effect on net profit/loss are also confirmed by Devi, Tri, and Ralina (2020), if Sharia Bank has a lower number index ranking, it will increase profitability. This finding is in line with Adebayo, et al, (2014) who found GCG factors: board size, board and management skill, CEO tenure, size and independence of audit committee, foreign and institutional ownership, dividend policy, and annual general meeting, all have a positive correlation with the performance of organizations. Transparency carried out by Islamic banks will increase the trust of stakeholders and customers, which in turn will make customers willing to use banking services.

The second significant factor is earnings reflected by ROE and BOPO. The independent variable is the effect of the return on equity on net profit/loss. The more a bank is able to return investments made by investors, the greater the net profit will be. Generally, shareholders will look for companies that provide good returns because they will be more profitable.

T-test result also shows that the BOPO have a significant and negative effect on Sharia Bank performance. The better the bank manages its operational activities, the more it will increase its net profit. The BOPO indicator is usually also used to measure banking efficiency. That is, the more efficient a bank is, the more it will affect its performance or net profit.

Meanwhile, the independent variables Non-Performing Financing (NPF), Financing to Deposit Ratio (FDR), Return on Assets (ROA), and Capital Adequacy Ratio (CAR) have a significance value higher than 0.05, so it can be stated that the hypothesis first (H1), second hypothesis (H2), fourth hypothesis (H4) and seventh hypothesis (H7) are rejected which means that NPF, FDR, ROA, and CAR partially have no effect on the net profit/loss of Sharia Commercial Banks in Indonesia for the 2017-2022 period.

The factors that are not significant to the net profit/loss of Islamic Commercial Banks are the risk profile and capital. The risk profile used by NPF and FDR has no effect on profitability. NPF does not affect Sharia Commercial Banks' net profit/loss because the NPF value-finding data in this study shows an inconsistent correlation with the company's net profit. NPF reduction data which is a decrease in non-performing financing should have led to a high company net profit, but the existing data provides different facts. The results of this study support El Adawiya's research (2020) which states that the NPF and FDR in the 2009-2012 period did not have a significant effect on the net profit of Sharia Commercial Banks.

## F-Test

Table 4. F-Test Result

Test Type	F value	Sig.
F-test	6,749	0,000

Source: *Processed data, 2023*

The results of the F-test analysis showed a significance value of less than 0.05. This means that all the independent variables in this study jointly affect the net profit/loss of Sharia Commercial Banks in Indonesia for the 2017-2022 period. According to the F-test result, all RGEN factors simultaneously affect net profit/loss in Sharia Commercial Bank. This result supports the research of Tilawah and Amalia (2021) and reveals that the soundness of Sharia Bank will increase financial performance.

## CONCLUSION

This study examines the impact of bank health factors on the performance of Sharia banks in Indonesia using the RGEN approach. The study concludes that Good Corporate Governance (GCG), Return on Equity (ROE), and Operating Costs to Operating Income (BOPO) have a significant impact on net income/loss. Furthermore, all RGEN variables simultaneously affect bank performance, explaining half of the impact.

This study offers recommendations for the implementation of GCG as a key factor in achieving better performance so it needs more attention. The implementation of GCG in Sharia banking is essential, not only to build a sound and robust Islamic banking industry but also to increase Sharia Bank's performance (Devi, Tri, and Ralina, 2020). In addition, ROE and BOPO show the need for efficient use of equity and operational costs so that Sharia banks can optimize revenue. Moreover, it is suggested that future research can add other variables related to RGEN and also increase the research period to make it more comprehensive.

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