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Analysis of the Determinants of Financing Risk in Islamic Banks in Indonesia

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Determinan; Financing Risk; Bank Syariah

ABSTRACT
This research aims to analyze the factors affecting Islamic banks' financing risks. The data used in this study are from Sharia Commercial Banks nationally, with observations from 2018 to 2022 for a monthly time period, while the model in this study is multiple linear regression. The results of the study show that internal factors, such as ROA and CAR, have a significant negative effect on financing risk, while BOPO has a significant positive effect on financing risk. The conclusion of this study emphasizes the importance of bank performance in minimizing risks faced by banks, as well as the need to improve operational efficiency and human resource management.

Introduction

In Indonesia, the first Islamic bank was established in 1991, which is a bank whose operation is based on Islamic sharia principles. In the last banking law (Law No. 21 of 2008), it is implied that Sharia principles include rules of agreement based on Islamic law between banks and other parties to deposit funds and/or finance business activities or other activities that are declared in accordance with sharia (Mardani, 2015). Islamic bank activities that are in accordance with Sharia principles include; Financing based on the principle of profit sharing (*mudharabah*), financing based on the principle of capital participation (*musharakah*), the principle of buying and selling goods with profits (*murabahah*), financing of capital goods based on the principle of the pure lease without option (*ijarah*), or with the option of transferring ownership of goods leased from the bank by other parties (*ijarah wa iqtina*) (Zuhirsyan, 2018).

The development of information technology is a demand for Islamic bank banking to develop various types of products. In order for products and systems to always run in accordance with Sharia principles, the National Sharia Council of the Indonesian Ulema Council (DSN-MUI), as a regulator, issues fatwas that can accommodate the needs of Islamic banking so that it is always within the corridor of Islamic law. One of the important principles that must be complied with by Islamic banks in fund management must be free from the element of riba it. Interest rates, which are applied as a source of income for conventional banking institutions, cannot be applied by Islamic banks because they are considered to be closely related to usury. As a substitute for interest rates, a profit-sharing system is used as an alternative way of accepting Islamic banking businesses. The prohibition of using the interest system is a very important distinction between Islamic banks and conventional banks.

Islamic banking is a system designed for collective economic activity, whereby the profits are shared between the investors (shahibul mal), the financial institutions acting as the fund managers (mudharib), and the borrowers or business managers who require funds (Abbas et al., 2020; Chamberlain et al., 2020). The evolution of Islamic banking is inextricably linked to the inherent risks that have the potential to disrupt the continuity of the banking business. Banks must implement risk management as a methodology and set of procedures designed to identify, measure, monitor, and mitigate risks associated with all aspects of their business activities (Rahmawati & Mulyati, 2021). The financing process provided to customers by banks is susceptible to potential issues or instances of poor financing. Financing risk is defined as the potential for loss resulting from the inability to recover funds disbursed. Non-performing financing is defined as financing that is of poor quality and falls into one of three categories: current, doubtful, or stuck (Djamil, 2012). In Islamic banks, this condition is reflected in the significant ratio of non-performing financing, commonly referred to as Non-Performing Financing (NPF). NPF serves as an indicator of non-performing financing that warrants consideration due to its volatile and uncertain nature. Consequently, it is essential to pay special attention to NPF as it represents a crucial performance assessment instrument for Sharia banks. This is particularly evident in the assessment of non-performing financing. .

The source of problematic financing can be attributed to external or internal influences. From an external perspective, macroeconomic variables such as GDP, inflation, and margin rate have been identified as key factors influencing bank performance (Ahmed et al., 2021; Ongore, 2011). As a developing country, Indonesia's economic conditions exert a considerable influence on the operations of its banking sector. Macroeconomics is inextricably linked to the phenomenon of inflation, which can be defined as a sustained increase in the general price level. In other words, inflation represents a continuous decline in the purchasing power of a currency. If inflation is relatively mild, it can have a positive impact on economic activity, such as fostering a greater propensity to invest. Conversely, in conditions of severe inflation, the state of the economy becomes chaotic and unstable.

Meanwhile, internal influence comes from operational activities within the banking itself which are contained in financial performance. The financial performance of a bank can be seen through its financial ratios as an indicator of health as well as an analytical tool to predict the profits that will be generated. The results of the research by Hosen and Muhari (2019) show that the intrinsic factors that affect NPF are *Return on Equity* (ROE), which has a negative significant influence on NPF while *Financing to Deposit Ratio* (FDR) has a positive significant influence on NPF. Different results were found by Havidz and Chandra (2015), *Capital Adequacy Ratio* (CAR), ROA, and FDR had no significant effect on NPF. Based on the background that has been explained, the purpose of this paper is to analyze both external and internal factors that affect financing risks in Islamic banks in Indonesia.

Research Methods

The analysis method in this paper is Quantitative, namely by analyzing a problem or phenomenon based on data and combining it with regression analysis. The data used in this study is *time series* data and is secondary data obtained from the publications of BPS (Central Statistics Agency), BI (Bank Indonesia), and OJK (Financial Services Authority). The unit of analysis in this study is Sharia Commercial Banks nationally with an observation period from 2018 to 2022 with a monthly time period. The models used in this study are as follows: (Ikatan Bankir Indonesia, 2018)

$$NPF_t = \beta_0 + \beta_1 ROA_t + \beta_2 BOPO + + \beta_3\, CAR_t + + \beta_4\, Rate_t + + \beta_5\, Inflasi_t \varepsilon_t$$

Information:

ROA	= *Return on Equity* in the period
NPF	= *Non-Performing Financing* periode t
BOPO	= Operating Expense Operating Income in the period t
CAR	= Capital Adequancy ratio pada periode t
BI rate	= BI interest rate in the period t
$Inflasi_t$	= inflation in the *period* t

Results and Discussion

NPF is an indicator of non-performing financing that warrants consideration due to its volatile and uncertain nature. Moreover, NPF serves as a performance assessment instrument for Islamic banks, offering an interpretation of productive asset valuation, particularly in the context of non-performing financing assessment. As illustrated in the following chart, based on data from the OJK, the NPF of Islamic banks from 2008 to 2022 tends to be stable:

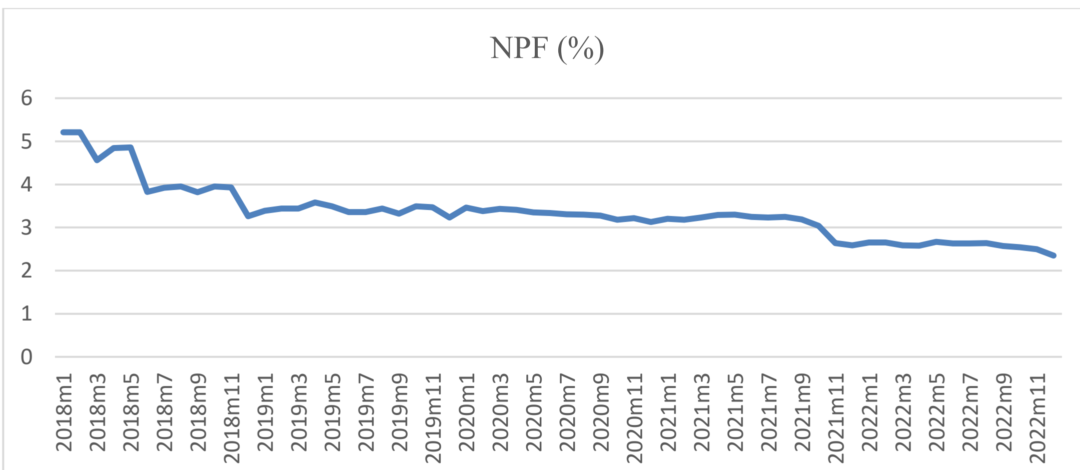

Figure 1. Sharia Bank NPF 2018-2022

Source: Sharia Banking Statistics; Data processed

Furthermore, in analyzing the determinants of financing risk, the author analyzes with a simple regression analysis. The results of estimation with *time series* data are obtained:

Table 1.
Results of Regression Determinants of Sharia Bank Financing Risk

	Variable Dependencies NPF
ROA	-0.4530384**

	(0.2121606)
BOPO	0.0471848**
	(0.219384)
CAR	-0.121292***
	(0.03903)
BI-rate	-0.0791603
	(0.0718565)
Inflasi	2.945954
	(2.585504)
R-sq	0.66
Number of Observation	60

Description: *** significant 1 percent, ** significant 5 percent, * significant 10 percent, (), standard error.

Source: Author data processing results

From the results of the data processing above, it shows that the variables that have a significant effect on the risk of Islamic bank financing are only internal factors, namely; ROA, BOPO and CAR. This is in line with previous research by Ghosh (2015) and Sabir (2012), which stated that there is a negative influence between ROA as a performance factor on non-performing loans (NPF). Because the better the bank's performance, the less financing risk occurs. Furthermore, the variables that affect bank financing risk are the level of bank efficiency or BOPO and the capacity or *size* of the bank which is explained by the CAR variable. BOPO has a positive effect on financing risk, meaning that if BOPO increases, bank financing risk also increases. The results of this study are in line with the research of Louzis, Vouldis et al. (2018) who stated that there is a positive influence between BOPO and NPL. A high BOPO value indicates poor performance, so if the BOPO is high, the NPF will increase. Meanwhile, the CAR variable has a negative effect on the financing risk of Islamic banks. This finding is also consistent with the findings of Diyanti (2012), which indicate that the higher the capital owned by banks, the more readily they can finance risky assets. Similarly, if credit is not accompanied by sufficient capital, it may result in non-performing loans. Therefore, it can be concluded that a higher CAR is associated with a reduction in credit risk faced by banks.

Conclusion

Factors that affect financing risk in Islamic banks are internal factors only, in the sense of the bank's own performance. ROA and CAR have a significant negative effect on financing risk in Islamic banks, while BOPO has a significant positive effect on financing risk in Islamic banks. From the results of these findings, it can be concluded that bank performance is very important to minimize the risks faced by banks. Therefore, in carrying out its operations, banks must improve human resources and manage or operate their activities efficiently.

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