Analysis the Effect of Islamic Banks Performance on Depositor's Fund: Evidence from Indonesia

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Abstract

This study aims to examine the effect of CAMEL framework on depositor's fund of Indonesian Islamic banks. The study uses a sample of 11 Islamic commercial banks and 24 Islamic business units'. It used depositors fund as the endogenous variable, and some components of CAMEL such as capital adequacy, assets quality, operational efficiency, profitability, and liquidity as exogenous variables. An econometric model was established and parameters are estimated based on the secondary data obtained from Islamic banking statistics-Bank of Indonesia database for five years (2010-2015). The results of the paper conclude that capital adequacy ratio and liquidity are significant and positively correlated to Islamic deposits, while nonperforming financing is significant but negatively related to the Islamic depositor's fund. On the other hand, profitability and operational efficiency are not to be significant influence on the depositor's fund. Finally, the statement of theory proved that good Islamic banks performance provided positive image and confidence in Islamic banking system.

Keywords: depositor's fund, CAMEL, operational efficiency, liquidity, profitability

1. Introduction

Islamic banking system in Indonesia has significantly emerging and growing over the last fourth decades. It achieved an impressive growth in assets, Islamic financing and deposits respectively. Moreover, most financial indicators are also very promising when we look at its total assets that have reached to 274 trillion rupees by the end of 2015, which grew by 5 percent compared with year of 2014. Meanwhile, total financing increased by 17 percent compared with year of 2015, and Islamic deposits have reached to 220 trillion rupees at end of the year 2015 (Bank of Indonesia, 2015).

In fact, financial and operational performance of Islamic banks is very important to behavior of depositor's fund, because it has an influence on their invested fund. Furthermore, depositors are interesting more carefully to managing their money placing in Islamic banks in order to ensure that their funds are being invested prudently. Therefore, financial performance is commonly classified into several aspects such as capital requirements, assets earning quality, operational efficiency, profitability and liquidity (Bashir, 2001). These aspects enable the banks to evaluate their financial and operational activities based CAMEL framework (Hasbi & Haruman, 2011). Thus, we are looking to analyze the assets and liabilities side beside operational activities carefully in order to protect and manage Islamic depositor's fund and reinforce the public trust towards Islamic banking system.

One of the important objectives that study attempts to achieve is to utilize Islamic banks assets in order to maximize their invested depositor's fund. Further, it seeks to improve components of CAMEL as much as possible in order to attract more depositors' fund. It also argues Islamic banks are potentially exposed various kinds of risks such as liquidity and operational risks which might effect on depositors fund (Zaini & Rosly, 2008). Thus, Islamic banks performance is playing a vital role in managing Islamic bank depositor's fund.

In Indonesia, Islamic banking system carried out its funding and financing activities through two kinds of deposits, namely demand deposits and investment deposits. These funds are invested in the business community as Islamic financing contracts such as Murabahah, Musharakah, and Mudarabah financing (profit-sharing financing and sales-based financing) as mentioned by research of Ismal (2011) and Wijaya (2008). Therefore, the good Islamic bank performance can improve the public trust who have an excess fund that might increase public saving and number of depositors in the bank. However, the performance of Islamic banks in Indonesia is

evaluated and restricted according to Bank Indonesia Act No.9/1/PBI/2007.

The aim of this study is to understand the behavior of depositors fund regarding to the performance of Indonesian Islamic banks. Therefore, data variables of depositors' fund are analyzed based on monthly data series from period of 2010 until 2015 involved by recovery from global financial crisis. Moreover, this study used five bank' specific variables which are capital adequacy, assets quality, operational efficiency, profitability and liquidity in order to estimate the amount of its effect on depositor' fund. So, finding the effect of financial performance on depositors fund is important for the banks in order to understand the financial characteristics that contribute in improving their financial policy and increase their assets market share compared with conventional banks. On the other hand, it makes depositors strongly confident in investing their fund in Islamic financing way.

This research article is planned as follows: section I is introductory part of study. Section II is a briefly summary of literature review. Section III explains data variables and the research methods. Section IV is a research variables and hypotheses. Section V is a discussion of research findings and section VI concludes the research paper.

2. Literature Review

The research explores the Islamic banking literatures of Islamic deposits as well as the previous studies that analyzed the relationship between Islamic banks performance and depositors fund. The earliest references to the reorganization of banking on the basis of profit-sharing rather than interest rate are found in Quershi (1946), Ahmad (1952), and Siddiqi (1981). They replaced interest rate with Profit-loss sharing (PLS) rate in order to avoid interest rate in Islamic financial transactions to be compliment with Islamic principles. Siddiqi (1981) added under the PLS system, the assets and liabilities of Islamic banks are integrated in the sense that borrowers share profits and losses with the banks, which turn share profits and losses with the depositors

In Islamic banking system, the surplus spending units deposit their funds with banks, which in turn lend their fund to deficit spending units, since any financial system deals with the nature or character of principles guiding the flow of fund from the surplus spending units to the deficit spending units, it is relatively simple how to explain the nature of Islamic banking system (Rosly, 2005).

Khan and Mirakhor (1987) mentioned that nominal value of investment deposits are not guaranteed and will fluctuate according to the performance of bank, any shocks to the Mudarabah and Musharakah arrangements will change the value of deposits and capital that held by public. In this context, Sundararajan and Errico (2002) stated that over all degree risks of assets financing of banks may shift to their investment depositors, partially the risks that come from equity-based financing (Mudarabah and Musharakah). Furthermore, Rosly (2005) argued that Islamic bank deposits are not attractive option if Islamic investments indicate higher transaction costs. This means the higher operating expenses over than operating income may decline the volume of depositors fund in Islamic banks. Meanwhile, Zaini and Rosly (2008) analyzed the risk and return of Islamic bank investment depositor's fund. They found bank performance has significant effect on investment deposits. However, the higher credit risks and nonperforming financing may depreciate the value of capital and depositors fund in Islamic bank.

Considering to the Islamic bank performance evaluation, Manarvi (2011) mentioned that Islamic banks are assessed over all soundness of bank and ensured the healthy condition by components of CAMEL similar of conventional bank. Sahajwala and Bergh (2000) argued that the performance of Islamic banks are evaluated different aspects of financial activities such as adequacy of risk based capital, assets growth rate, profitability and liquidity based on conventional foundation model of CAMEL that released by U.S. Federal reserve bank in 1980, which commonly assessed both conventional and Islamic financial institutions. While, Sarker (2006) stated that CAMEL model seeks to assess and track changes in a bank financial condition and risk profile in order to generate timely warning for the regulator to help initiate warranted action. He argued that CAMEL is a good indicator which reflects bank financial condition and interest of depositors, because it is interacted with each item of assets and liabilities side.

Under bank performance theory each financial institution evaluated on the basis of five dimensions of CAMEL which reflect all financial and managerial aspects of bank, include: Capital adequacy, Assets quality, Management quality, Earnings, and Liquidity. Hasbi and Haruman (2011) argued that these five dimensions have relative significant influence on depositor's fund. They found that capital adequacy and operational efficiency have significant and positively related to depositors, while the variables profitability, assets quality, and liquidity haven't significant influence on depositor's fund. Moreover, other studies from Indonesia such as Muhtarom (2009), and Sumachdar and Hasbi (2010) implicitly stated that the increase in financial performance has a straight relationship with third party funds in the bank. On other hand, Al Deehani et al. (2015) examined the

performance of Islamic banks before and during the economic downturn in 25 Gulf countries. They used Islamic financing/asset and deposit/ asset ratios to measure Islamic bank performance. It found that Islamic banks are more stable than conventional banks before and during the crisis.

The limitations of prior studies are that most of them were focused on discussion the financial characteristics of Islamic banking industry compared with conventional one. In fact, there were few previous studies that have filled the research gap in understanding the relationship between banks performance and their depositor's fund, specially the effect of some risks such nonperforming financing and operational risks on depositors fund. Therefore, depositors fund modeling has not been primarily discussed in area of Islamic finance. As a result, this research attempts to understand the directional relationship between some bank specific factors and behavior of depositor's fund.

3. Data and Research Methods

This research attempts to find out the influence of some aspects of bank performance on depositor's fund. The data observation consists of all Islamic commercial banks in Indonesia. Furthermore, the data analysis based on monthly time series starts from January of 2010 until December of 2015. The final sample was 11 Islamic banks and 24 Islamic business units. As a result, the total of 60 observations is included in the analysis. In fact, this number is quite enough to achieve some meaningful significant results. Further, multiple regression analysis is used in order to examine the effect of some certain bank performance indicators {capital adequacy ratio (CAR), nonperforming financing (NPF), operational efficiency (OEOI), profitability (ROA), and liquidity (FDR)} on depositors Fund (DF). However, Islamic banks in Indonesia have a few primary empirical studies that investigated in the relationship between bank performance and behavior of depositor's fund. Hasbi and Haruman (2011) analyzed the effect of CAMEL rating system in depositor's fund. They found that there is positive effect of some financial indicators on Islamic deposits.

As result, this study contributes the understanding of banking performance vital role in attracting more depositors fund and reinforcing public trust in Islamic banking system. Therefore, theory statement of this research states that good Islamic performance has a positive image on the public perceptions and depositors in Indonesian Islamic banks. Moreover, this research extends Islamic banking methodology through enhancing the profitability and assets market share of Islamic banks compared with conventional banks.

4. Research Variables and Hypotheses

The main objective of this research is to explain the variability of depositors fund (DF) regarding to the influence of components of CAMEL and performance. Therefore, depositors fund variable is considered the primarily interested variable for the study and used as a measurable tool of the public trust in Islamic banking system. Thus, this parameter is measured and used by Hasbi and Haruman (2011) as follows:

$$DF = (Demand\ deposits + Investment\ deposits) \tag{1}$$

There are five bank specific characteristics (CAMEL) that measured bank performance which are defined and described as follows:

Capital Adequacy Ratio (CAR), capital adequacy ratio is defined as situation where the adjusted capital is sufficient to absorb all losses and cover fixed assets of the bank leaving a comfortable surplus for the current operation and future expansion (Ebhodaghe, 1991). It measured bank capital (reserves, paid in capital, retained earnings, and current earnings) compared with risk weighted assets (Sarker, 2006). Therefore, this variable is calculated by:

$$CAR = (Bank\ capital/\ Risk\ weighted\ total\ assets) \tag{2}$$

H_1: Capital adequacy ratio has a statistically significant influence on depositor's fund of Indonesian Islamic banks.

Nonperforming financing (NPF), is defined as the level of bad financing that had been reserved. It measured the assets quality of bank and it also described the capacity of bank in spreading risks and recovering default loans (Sundarajan & Errico, 2002). The lower ratio, it means that the better earning assets quality. Thus, it is calculated as follows:

$$NPF = (The\ amount\ of\ default\ from\ financing/\ Total\ financing) \tag{3}$$

H_2: Nonperforming financing has a statistically significant influence on depositor's fund of Indonesian Islamic banks.

Operational efficiency (OEOI), used to gauge management soundness, and that occurred by using operating

expenses to operating income ratio (OEOI) as stated in study of Sahajwala and Bergh (2000) and Sarker (2006). They argued that OEOI could be used as indicator to evaluate management quality of the bank. Therefore, the higher OEOI, the higher operational inefficiency of the bank, it is calculated by:

$$OEOI = (Operating\ Expenses\ /\ Operating\ Incomes) \qquad (4)$$

H3: Operational efficiency has a statistically significant influence on depositor's fund of Indonesian Islamic banks.

Profitability (ROA), there are several indicators of profitability such ROA and ROE, while most studies prefer to use return on assets (ROA) because it is the more effective utilization of total asset to generate profit effectively and efficiently. Rosly (2005) defined return on asset as net income after tax divided by total assets. Thus, it is calculated as follows:

$$ROA = (Net\ income\ /\ Total\ assets) \qquad (5)$$

H4: Profitability has a statistically significant influence on depositor's fund of Indonesian Islamic banks

Liquidity (FDR), indicated as the capability of a bank to meet short term obligations and occasional withdrawals, in other words the degree which of bank assets convertible to cash with undue losses (Sundarajan & Errico, 2002). Hasbi and Haruman, (2011) used total financing to total deposits ratio as indicator to measure liquidity of Islamic banks. Therefore, it is calculated by:

$$FDR = (Total\ financing/\ Total\ deposits) \qquad (6)$$

H5: Liquidity has a statistically significant influence on depositor's fund of Indonesian Islamic banks

5. Research Findings and Discussion

5.1 Descriptive Statistics

Table 1 exhibits the descriptive statistics for the research variables that used in conducting the results of this study. It shows the average (mean), standard deviation, maximum, and minimum value of all explanatory variables and depositors fund.

Table 1. Descriptive statistics

Variable	Mean	Std. Dev	Max	Min	N
CAR	0.1467	0.0247	0.2023	0.0850	60
NPF	0.0424	0.0083	0.0572	0.0252	60
OEOI	0.8757	0.0439	0.9209	0.7386	60
ROA	0.0285	0.0030	0.0344	0.0057	60
FDR	0.9732	0.0867	1.2010	0.8690	60
DF	210742.6	25958.9	255,345	150,435	60

The depositors fund has a mean value of 210.742 billion for Islamic commercial banks with a standard deviation of 25958.9. Further, the capital adequacy ratio is 14.7%, this means that Islamic banks in Indonesia hold the minimum capital of 8% beyond the amount required by regulation, where standard deviation is 2.47%. Moreover, the nonperforming financing has a mean value of 4.24%, with a standard deviation of 0.83%, this means that the percentage default loan from financing is 4.2% on average. Table1 shows that operational efficiency measured by OEOI has a mean value of 87.6% while standard deviation 4.39%. It indicates that operating expenses less than operating income because this ratio is less than 1. In the same manner, the average profitability that measured by ROA is 2.85% with a standard deviation of 0.3% which is slowdown over the period of study. The result of statistical analysis also shows that the average of financing to deposit is 97% less than 1 with standard deviation 8.67%. This means that Islamic financing unable to cover depositor fund which has an effect on liquidity position of Islamic bank.

5.2 Classic Assumption Tests

5.2.1 Testing Stationary of Data

Table 2 shows whether data variables are get stationary or not. It used Augmented Dickey- fuller (ADF) test based on the unit root test of null hypothesis (H_0) by using EVIEWS 6.0 statistic program.

Table 2. Augmented Dickey Fuller test

Variable	ADF test statistics	Critical value	Durbin Watson	Lag difference	p-value
CAR	-7.9147*	-3.5572	1.9730	-1	0.000
NPF	-6.6748*	-3.5572	1.9509	-1	0.000
OEOI	-5.3537*	-3.5572	2.0542	-1	0.000
ROA	-6.8294*	-3.5572	2.0410	-1	0.000
FDR	-5.5130*	-3.5572	1.9900	-1	0.000
DPK	-8.8336*	-3.5572	2.0450	-1	0.000

*significant level at 1%.

This table concludes that absolute computed ADF test statistics for research variables is smaller than critical value (-3.5572) at 1% significance of level. Thus, null hypotheses (H_0) are rejected. This indicates the 1st lagged difference level of all variables gets stationary series. It can be said that the result is reliable because DW is closed to 2. Therefore, the data variables have no autocorrelation problem.

5.2.2 Testing Normality of Data

Table 3 presents the Skewness of ± 2.58 at significant level of 0.01 and multivariate critical value as the criteria of testing normality of data variables.

Table 3. Normality test assessment

Variable	Max	Min	skew	C.R.	kurtosis	C.R.
CAR	0.302	0.065	0.501	1.212	-0.288	-0.532
NPF	0.058	0.035	0.035	0.045	-0.856	-1.217
OEOI	0.921	0.739	0.372	1.137	-0.241	2.264
ROA	0.024	0.006	-0.936	-2.861	3.228	4.931
FDR	1.201	0.869	1.664	5.083	1.482	2.264
DPK	99278	22044	0.670	2.047	-0.931	-1.422
Multivariate					10.433	3.086

The result of table 3 represents that all variables of Skew are less than the critical value of ± 2.58. This means that the data distribution is normal as a univariate. While, multivariate tests provide critical value of 3.086, which is still fewer than 10.000 as mentioned by Ghozali (2011). Therefore, this research can be concluded that the data variables have a normal distribution as a multivariate.

5.2.3 Testing Correlation among Variables

Table 4 shows the Pearson correlations among different variables of the research model using two tailed test. The table concludes that there are low correlations among explanatory variables. It can be said that data variables have no multi-co-linearity problem.

Table 4. Pearson correlation coefficients

Variable	CAR	NPF	OEOI	ROA	FDR	DPK.
CAR	1					
NPF	-0.624**	1				
OEOI	-0.416**	0.323*	1			
ROA	-0.105	0.237	-0.562**	1		
FDR	0.198	-0.527**	-0.183	-0.181	1	
DPK	0.749**	-0.822**	-0.293*	-0.309*	0.613**	1

*and** correlation is significant at level 5% and 1% (2 tailed) respectively.

It also shows that depositors fund has positively correlated with capital adequacy ratio (0.749) and liquidity measured by FDR (0.613) and significant at 1% levels. This means that higher capital adequacy is more able to attract the depositor's fund and also higher liquidity position increases depositors fund. This result is consistent

with research conducted by Hasbi and Haruman (2011). Whereas, nonperforming financing is significant but negatively correlated with depositor fund (0.822) at significant level of 1%. This argues that high level of uncollectable fund from Islamic investments will result to decline the value of depositor's fund. On the other hand, depositor fund is negatively correlated with operational efficiency (0.293) and profitability (0.309) and significant at 5% levels.

5.3 Multiple Regression Analysis

This research aims to find out the effect of Islamic banks performance on depositors fund by using multiple regression analysis. Multiple regressions could be useful to predict the relationship between components of CAMEL and depositors fund. Accordingly, this research can formulate the relationship between five dimensions of CAMEL (CAR, NPF, OEOI, ROA, and FDR) and depositors fund (DF) through using the following hypothesized model:

$$DF= f (CAR, NPF, OEOI, ROA, FDR)$$

Based on the above function the study seeks to examine whether the depositors fund could be explained by Islamic bank performance indicators. Therefore, the multiple regression equation is applied as follows:

$$DF_{it} = \alpha_0 + \beta_1 (CAR_{it}) + \beta_2 (NPF_{it}) + \beta_3 (OEOI_{it}) + \beta_4 (ROA_{it}) + \beta_5 (FDR_{it}) + z_1$$

Where the variables are defined and discussed in section 4. (i) and (t) represent Islamic banks and the number of monthly observation respectively. While, β_1 - β_5 are coefficient effect of variables and z_1 is error term. This study uses ordinary least square method for estimation depositor fund by using SPSS statistics program as follows:

Table 5. Coefficients

Model	Unstandardized Coefficients		Standardized coefficients		
	B	Std. error	Beta	t	Sig.
Constant	1289.016	268.896		4.794	0.000
CAR	41968.785	18949.238	0.261	2.215	0.031
NPF	-196331.326	72682.114	-0.345	-2.701	0.009
OEOI	19111.849	9592.629	0.284	1.992	0.052
ROA	-54607.503	106826.034	-0.073	-0.511	0.612
FDR	15939.578	7771.500	0.283	2.051	0.046
Model summary b	R	R square	F	Durbin Watson	Sig
	0.583	0.34	5.049	2.087	0.001

Predictors: (constant), CAR, NPF, OEOI, ROA, FDR;

Dependent variable: DPK.

Based on the above table, the model result arranged as follows:

$$DF = 1289 + 0.261CAR - 0.345NPF + 0.284OEOI – 0.073ROA + 0.283FDR$$

$$(4.794) \quad (2.215) \quad (2.701) \quad (1.992) \quad (0.511) \quad (2.051)$$

According to the result in table 5, the model summary is fit well in terms of R square (0.34), F value (5.049), and Durbin Watson (2.087). This means that data of model had no autocorrelation because DW is closed 2 and that confirms the result of classic assumption test. While, explanatory power (R^2) of 34% which shows the explanatory variables influence on depositors fund by 34% and for the remaining 66% influenced by other variables not included in the research model. This means that the variables CAR, NPF, OEOI, ROA, and FDR simultaneously affect the Islamic banking depositors fund amounted to 34%, while the remaining 66% influenced by other variables not included in regression model above.

Table 5 also concludes that the variable capital adequacy ratio has a significant and positive relationship with depositor's fund. It has t–value of 2.215 and p–value 3.1% less than significant level at 5%. This indicates that the higher capital requirements by Islamic bank are highly attractive depositor fund. This result is consistent with the findings of Hasbi and Haruman (2011).

Nonperforming financing of bank is significantly and negatively correlated with depositor's fund. It has also a t-value of -2.70 and p-value 0.9% less than significant level at 5%. This means that the higher uncollectable loan receivables are lower the volume of depositors fund and public trust in Islamic banks. This relationship is consistent with the result of research conducted by Zaini and Rosly (2008).

This research used FDR as a proxy of liquidity; it shows a significant positive relationship with depositor's fund. The t value is 2.051 and p value 0.046 is less than significant level at 5%. This means depositors fund is highly involved by higher degree of liquidity in Islamic banks. This result is consistent with the findings of Hasbi and Haruman (2011) and Ismal (2011).

Finally, the regression results found limited support for a direct relationship between depositors fund and profitability measured by ROA. The return on assets ratio is not to be significant at 5% level. This result is contrary with research of Hasbi and Haruman (2011). Moreover, this research found that operational efficiency measured by OEOI does not significant influence on depositor's fund at 5% of level.

6. Conclusion

This research paper attempts to find out the bank specific financial variables (CAMEL) that influence on depositors fund in the case of Indonesian Islamic banks. On the basis of the results of research, five components of CAMEL system are used as explanatory variables which are: capital adequacy, assets quality, management quality; profitability and liquidity. It reveals that only three variables (capital adequacy, assets quality, and liquidity) of five are found statistically significant effect on depositor's fund. However, the rest two variables (operational efficiency and profitability) are not be significant. Furthermore, we can conclude that Islamic banks in Indonesia can change their depositors fund based on the capital adequacy requirements, assets quality measured by nonperforming financing, and liquidity position. These results are consistent with earlier studies such as Zaini and Rosly (2008), Hasbi and Haruman (2011) and Ismal (2011).

Generally, this research found that some indicators of bank performance have a positive effect on the behavior of depositors and public perceptions toward Islamic banks such as capitalization and liquidity. This means that high degree of capital requirements and liquidity will generate high level of depositor's fund. However, the increase of nonperforming financing or uncollectable fund due to the default risks of some investment projects will result to decline the confidence of public in Islamic banks. Moreover, this study confirmed that nonperforming financing declines the assets earning utilization of Indonesian Islamic banking industry. On the other hand, this research revealed that profitability position still slowdown growth due to the limited Islamic financing strategy and conservative policy towards taking huge risks in sharing financing. This research indicates that Islamic banks operational efficiency is well managed. Therefore, there is no effect of operating expenses to operating income ratio on depositor's fund.

According to these results, the researcher revealed that profitability of Islamic commercial bank is significantly slowdown. Therefore, the researcher suggests the need for optimization of Islamic bank assets which is to contribute revenue to the bank. The selection and proper use of financing will make profitability (ROA) to be optimal in order to improve confidence of depositors toward Islamic banking system. Moreover, this research suggests keep improving Islamic banks performance and intensifying profit-loss sharing financing by focusing on it more than debt-based financing will optimize short term and long term profit, with attention to credit and operational risks management, because the behavior of depositors are sensitive to credit and operational risks. Furthermore, the researcher suggests some alternatives available to invest fund under PLS financing such as Islamic banks joint financing for government and Islamic investment portfolio in infrastructure sectors such as education, health and social services.

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