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Factors Affecting Islamic Bank Financial Performance

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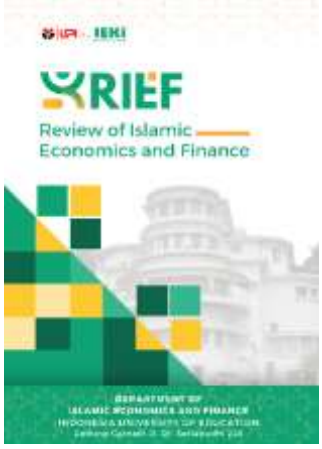

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Abstract

Purpose *– This study aims to investigate the factors affecting financial performance in Islamic banks.*

Methodology *- The quantitative approach is applied in this study with panel data analysis as analysis tool. This study measures the performance of Islamic Banks (IBs) in Türkiye and Indonesia. In total, there are 5 and 11 Islamic banks in Türkiye and Indonesia respectively used in this study, resulting 109 samples to analyze.*

Findings *- The results show that bank size, capital ratio, operating expense ratio and inflation are found to be significant on Return on Avergae Assets (ROAA) positively. However, bank age and loan ratio do not have significant effect on ROAA. It is important to evaluate these factors to improve financial performance of Islamic bank in both countries as big Muslim population.*

Keywords: *Indonesia, Islamic bank, performance, ROAA, Türkiye. .*

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1. INTRODUCTION

After emergence of Islamic finance practice in the 1960s, constantly this industry shows incredible growth along with offering various innovative and unique financial instrument and business model. Based on State of the Global Islamic Economy Report 2022 released by DinarStandard (2022), the total assets of Islamic finance reached USD 3.6 trillion in 2021, growing by 7.8% year on year growth and it is estimated to arise by 8% in 2022. This sector has rebounded in the first half of 2021 following a tough year during the peak of the pandemic. This report also revealed that this industry is also expected to grow with assets estimated to reach USD 4.9 trillion in 2025 after new normal has been implemented in many countries.

Among Islamic finance institutions, Islamic banking is known as fast-growing industry. Although pandemic hit many sectors, Islamic banking continued to rise in 2020, registering year on year growth of 14% to USD 2.3 trillion in Islamic finance global assets. At the same time, the share of Islamic banking was 70% in 2020, making Islamic banking as the biggest contributor to global Islamic finance assets (Refinitive, 2021). While Islamic banking has shown progressive development, Islamic banking in most countries has recorded low market share of the total domestic banking. Only Iran, Sudan, Saudi Arabia, and Brunei still maintains a high market share of Islamic banking assets above 60% (IFSB, 2021).

Islamic banking industry needs to gain high market share to have more significant contribution on socio-economic welfare. Ismal (2013) emphasized that low market of Islamic banking restricts Islamic bank activities, Islamic financial market activities, and the contribution of Islamic banking to the economy. Therefore, to reach higher market share, Islamic banking should be ready to compete with conventional banking by improving its performance. If Islamic banking maintains sustainable performance, the customers or investors are interested in utilizing Islamic bank's products and services. As a result, the Islamic banking would expand its operation and business and provide large contribution to the economy of country.

Achieving good and sustainable performance is very important issue for banking sector. Islamic banks (IBs) must formulate strategies to improve the performance as a means to generate optimal benefit. In addition, IBs need to maintain excellent performance to make bank resilient and competitive. The study regarding factors that affect bank performance, therefore, become essential. The studies on Islamic bank (IB) performance have been conducted by previous researchers such as Al-Naseer Mohammed and Joriah Muhammed (2017); Platonova, et al. (2018); Ajili and Bouri (2018); Al-Malkawi and Pillai (2018); Khanifah, et al. (2020).

Most previous studies have examined variables from bank's internal data such as bank size, leverage, capital ratio, loan ratio, corporate social responsibility, corporate governance etc. as independent variables towards IB performance. Not many of them have applied external variables as factors affecting IB performance as stated by Furqani and Mulyany (2009), revealing that the studies concerning the relationship between IB and macroeconomics variables are still rare. It is, thus, important to analyze factors influencing IB performance using both internal and external variables.

2. LITERATURE REVIEW

Business sectors, including banking, usually evaluate the business activities to see the performance of the company throughout the year. Through this evaluation process, the industry may determine new business target and strategies for the coming year. In banking sector, the performance assessment is necessary as this sector is intermediary institution that must be responsible for the

management of funds coming from third parties as investors. The performance measurement, therefore, is very important in banking sector. Moullin (2002) states that the performance measurement shows how well the organizations are managed and the achievement they deliver for customers and other stakeholders.

2.1 Performance Measurement

The performance measurement tool might be different among enterprises, it is dependent on enterprises' needs, policies, and strategies. In general, the performance measurement method is divided into two categories i.e., classical method and modern method (Bouheni et al., 2016). The classical method is method that measure the performance of company based on earning (profit). In other terms, the classical method is tool to measure the performance of company using financial performance such as ratio analysis, income statement, market value added etc. At the same time, the modern method is method to measure company performance using both financial aspects and non-financial aspects such as innovation, customer satisfaction and employee's motivation.

This study employs financial indicators as classical method to measure the Islamic banks' performance in Turkey and Indonesia. The financial performance uses financial indicators to represent the economic achievement of the firm. Furthermore, this study compares financial performance of Islamic banks in these two countries using ratio analysis. The ratio analysis is calculation and comparison of ratios which are derived from the information in a company's financial report. The level and historical trends of these ratios can be used to make inferences about company's financial condition. Financial ratio analysis has various categories explaining about different facets of a company's finances and operations (Bouheni et al., 2016; Gupta et al., 2011).

One of the financial ratios mostly used for assessing performance of a company is return on assets (ROA). ROA is measure of how efficiently a company uses the assets it owns to generate profit. The managers, analysts and investors look at ROA to determine a company's financial health. This indicator compares the value of company assets with the profits over a set period. In banking sector, this indicator is an expression of profitability for the entire activity. It is believed that the ROA is the most exact measure of banking activity due the fact that it determines how effectively a bank is using its financial resources (Birken, 2021). In fact, the value of a company's assets fluctuates over time due to market condition and demand or fluctuating cost of assets. As a result, calculating the average total assets for period is more accurate than the total assets for one period. The average asset is obtained by averaging the total asset in the beginning and the end of the year. So, return on average assets (ROAA) become much better to apply in this study. In general, the higher the ROAA, the more efficient the company is at generating profits.

There are some previous researchers conducting studies regarding performance of bank such as Al-Naseer Mohammed and Joriah Muhammed (2017); Alsartawi (2019); Al-Kayed et al. (2014); Athanasoglou et al. (2008); Al-Tamimi (2010); Al-Malkawi and Pillai (2018); Wasiuzzaman and Gunasegavan (2013); Khanifah et al. (2020). The studies analyzed factors influencing return on assets (ROA) as one of the bank profitability indicators. According to Al-Naseer Mohammed and Joriah Muhammed (2017), there is lack of studies regarding factors influencing IBs performance using bank internal and external variables. This study, therefore, includes banks' internal and external variables to examine their impact on IB performance as a means of filling the existent gap. After reviewing the previous studies, this study adopts bank size, loan ratio, capital ratio, operating expense ratio, and bank age as independent variables and internal variables as well while inflation is considered as external variable.

2.2 Hypothesis Development

In this study, there are some hypotheses proposed after reviewing literature and previous studies. The hypotheses proposed are as follows:

3.3.1. The influence of bank size on ROAA (H1)
Based on previous studies, there is relationship between bank size and ROA. The study conducted by Alsartawi (2019) showed that bank size influence ROA positively and significantly. The log of total assets is used as proxy of bank size. Also, Haron (1996) stated that since large bank are assumed to enjoy economies of scale, they are able to produce their output or service affordably and efficiently than the small banks. As a result, large banks will earn higher profit. So, the hypothesis between the bank size and ROAA is as follows:

H1. Bank size has positive impact on ROAA

3.3.2. The influence of loan ratio on ROAA (H2)
Platonova et al. (2018) have tested the relationship between loan ratio an ROA. The result of study showed that loan ratio has significant positive influence on ROA. The loan ratio is calculated by dividing total loans by total assets. The loan is one of the main capital sources in Islamic banking to generate profit. So, it is expected that the loan ratio will have positive impact on ROA for Islamic banking in Turkey and Indonesia. So, the second hypothesis for this study is as follows:

H2. Loan ratio has positive impact on ROAA

3.3.3. The influence of capital ratio on ROAA (H3)
Based on the previous studies, there is relationship between capital ratio and ROA. For example, the study conducted by Al-Kayed *et al*. (2014) demonstrated that there is positive relationship between capital ratio and ROA. The capital ratio is calculated by dividing total equity by total assets. The increase in capital can raise expected earnings by reducing the expected cost of bankruptcy. In addition to that, banks with high capital ratio are able to reduce the cost of external funding. So, the banks may earn higher profitability (Kosmidou, 2008). Therefore, the third hypothesis for this study is as follows:

H3. Capital ratio has positive impact on ROAA

3.3.4. The influence of operating expense ratio on ROAA (H4)
A number of empirical studies consider operating expense to be one of the major determinants of bank profitability. Athanasoglou *et al.* (2008) conducted study about the relationship between operating expense ratio and ROA. Operating expense ratio is calculated by dividing total operating expense by total assets. The results of the study showed that operating expense has negative effect on ROA. The effective management of operating expense is needed to boost the efficiency of banks and enhances the bank profitability. Therefore, it is expected that operating expense will negatively affect ROA for Islamic banking in Turkey and Indonesia. So, the fourth hypothesis for this study is as follows:

H4. Operating expense ratio has negative impact on ROAA

3.3.5. The influence of bank age on ROAA (H5)

Al-Malkawi and Pillai (2018) examined the relationship between bank age and profitability. The result of the study showed that bank age has significant positive impact on bank profitability. However, study conducted by Majumdar (1997) showed that older firms are found to be more productive and less profitable. Also, Alsartawi (2019) found that bank age has negative impact on ROA. So, the study regarding the relationship between bank age and profitability has been a debatable topic till date. Until now, there are positive and negative relationship between bank age and profitability. So, to see the relationship between bank age and ROA for Islamic banking in Turkey and Indonesia, this study uses hypothesis as follows:

H5. The bank age has impact on ROAA

3.3.6. The influence of inflation on ROAA (H6)

This study also will examine the influence of inflation as one of macroeconomic indicators on bank profitability. The study conducted by Wasiuzzaman and Gunasegavan (2013) discovered that inflation has positive impact on ROA. Inflation is measured as the per annum percentage change in the consumer price index (PCI). The higher inflation may cause higher income and higher costs. If the bank can manage the costs efficiently, the effect of inflation will increase bank profitability. So, the hypothesis for this study is as follows:

H6. The inflation has positive impact on ROAA

3. METHODOLOGY

The purpose of this study is to analyze financial performance of IBs in Turkey and Indonesia. This study uses quantitative approach for conducting the research. The quantitative approach in the research area can be construed as research strategy that emphasizes quantification in the collection and analysis data (Bryman, 2012).

3.1 Data and sample

This study selects the number of IBs in Turkey and Indonesia as sample. In total, Turkey has six IBs as listed in Türkiye Katılım Bankaları Birliği (TKBB). However, this study uses five IBs as one IB is new entrant into Islamic banking industry in Turkey. At the same time, Indonesia has various Islamic bank types available. The type of Islamic bank used in this study is Islamic commercial bank (ICB) because this type operates independently and possesses large bank capital. The total ICB in Indonesia is 14 as listed in Otoritas Jasa Keuangan (OJK). However, this study uses 11 ICB as sample because three ICB are new entrant into industry and do not provide enough data to be investigated.

In the analysis of factors influencing bank performance, this study uses internal data collected from annual reports of IBs available in each bank's website. In addition to that, this study also uses the external data obtained from Türkiye Cümhuriyet Merkez Bankası (TCMB) and Bank Indonesia (BI) as central banks in both countries. The type of data employed in this study is panel data.

3.2 3.2. Panel data analysis

This study examines the factors affecting IB financial performance using variables commonly used in the conventional bank as well. To conduct this analysis, this study applies panel data analysis. Panel data analysis is analysis using combination of cross-section data and time-series data (Andreb et al., 2013). Panel data analysis usually gives the researcher a large number of data points, increasing the degree of freedom and reducing the collinearity among explanatory variables. Hence, it improves the efficiency of econometric estimates. More importantly, panel data allow researcher to analyze a number of important economic questions that cannot be addressed using cross-sectional or time-series data (Hsiao, 2003). The variables used in this study is presented in the table below:

Table 1. The definition of dependent and independent variables

Variables	Definition
Dependent variable	
Return on average assets (ROAA)	Net Income/average total assets
Independent variables	
Internal variables	
Bank size (BS)	The Natural logarithm of total assets
Loan ratio (LR)	Total loans/average total assets
Capital ratio (CR)	Total equity/average total assets
Operating expense ratio (OER)	Total operating expense/average total assets
Bank age (BA)	The difference between the establishing date of Islamic bank and the report date
External variable	
Inflation (INF)	Per annum percentage change in the consumer price index (PCI)

After determining and defining the variables, the specification of the model can be formed. The following is the specification of panel data regression model for this study:

$$\mathrm{ROA}_{it} = \beta_0 + \beta_1 \mathrm{BS} + \beta_2 \mathrm{LR} + \beta_3 \mathrm{CR} + \beta_4 \mathrm{OER} + \beta_5 \mathrm{BA} + \beta_6 \mathrm{INF} + \mu_{it}$$

Explanation:

ROA	= Return on assets
i	= Cross-sectional unit
t	= Time-series
β_0 to β_6	= Intercept
BS	= Bank size
LR	= Loan ratio
CR	= Capital ratio
OER	= Operating expense ratio
BA	= Bank age
INF	= Inflation
μ_{it}	= Error term

In this study, unbalanced panel data analysis will be employed due to data availability. The observation year used for this study is shown in the table below:

Table 2. The number of observations

	No.	Bank	Observation Year	Total Observation
Turkey	1.	Albaraka Türk Participation Bank	2014-2020	7
	2.	Kuveyt Türk Participation Bank	2014-2020	7
	3.	Türkiye Finans Participation Bank	2014-2020	7
	4.	Ziraat Participation Bank	2015-2020	6
	5.	Vakıf Participation Bank	2016-2020	5
Indonesia	6.	Muamalat Bank	2014-2020	7
	7.	Victoria Islamic Bank	2014-2020	7
	8.	BRI Islamic Bank	2014-2020	7
	9.	BJB Islamic Bank	2014-2020	7
	10.	BNI Islamic Bank	2014-2020	7
	11.	Mandiri Islamic Bank	2014-2020	7
	12.	Mega Islamic Bank	2014-2020	7
	13.	Panin Dubai Islamic Bank	2014-2020	7
	14.	Bukopin Islamic Bank	2014-2020	7
	15.	BCA Islamic Bank	2014-2020	7
	16.	BTPN Islamic Bank	2014-2020	7
Total				**109**

4. RESULTS AND DISCUSSION

4.1 Descriptive statistics

Table 3 shows the results of descriptive statistics computed by EViews 12. The total observation for panel data analysis in Turkey is 32 while in Indonesia it consists of 77 observations. So, in total this study has 109 observations for period between 2014-2020. It also indicates that more IBs operates in Indonesia than in Turkey. Nevertheless, Turkey disclosed bigger IBs' average assets in 2020 than Indonesia at 38,160 million of Turkish Lira (TL) or 4,711 million of USD (1 USD = 8.1 TL in 2020) and 23,104 billion of IDR or 1,593 million of USD (1 USD = 14,500 IDR in 2020) respectively.

The mean of ROAA for IBs in Turkey during 2014-2020 was 1.03%. The minimum ROAA was owned by Ziraat Participation Bank in 2015 at -0.55%. This bank had negative ROAA because the bank was newly established in 2015. Meantime, the mean of ROAA for IBs in Indonesia was at 0.64%, lower than in Turkey. The minimum of ROAA was at -11.14, reached by Panin Dubai Islamic bank in 2017. This bank had the negative performance as there was tough situation in the bank management, resulting in misappropriation of funds (Salih, 2019). In general, ROAA of IBs in both countries is under 2%.

The mean of loan ratio of IBs in Turkey and Indonesia was between 70% and 80%. Also, the capital ratio of IBs in these countries was between 10% and 20%. In the terms of the average operating expense ratio, the ratio difference between two countries was only 2,45%. So, there were no great differences in these matters, indicating that IBs were nearly in the same performance.

Until 2020, the average of bank age for IBs in Turkey was 17 years old. Meanwhile, the average age of IBs in Indonesia was 12 years old. IB operation in Turkey has started earlier than in Indonesia, pioneered by Albaraka Participation Bank established in 1985. In the terms of inflation, from 2014 to 2020, the average annual inflation in Turkey was 11.58%. Based on data from world bank (World Bank, 2021), the inflation in Turkey was above 10% since 2017. Meanwhile, from 2014 to 2020 the mean of inflation in Indonesia is 3.70%. The inflation rates every year in Indonesia is under 5%. The big difference of annual inflation rate in Turkey and Indonesia was caused by different political economy and policies conducted by central bank of the country

Table 3. Descriptive statistics

	Variables	Observations	Mean	Minimum	Maximum	Stand. Dev.
Turkey	ROAA (%)	32	1.03	-0.55	1.90	0.51
	BS (in Millions of TL)	32	38,160.56	2,177	128,365	25,668
	LR (%)	32	77.61	57.35	109.66	13.46
	CR (%)	32	10.69	6.23	31.62	5.68
	OER (%)	32	8.05	4.64	11.85	1.58
	BA (Year)	32	16.88	1	35	12.42
	INF (%)	32	11.58	7.67	16.33	3.30
Indonesia	ROAA (%)	77	0.64	-11.14	10.21	2.66
	BS (Billions of IDR)	77	23,104.05	1,382	119,600	27,167.82
	LR (%)	77	72.81	41.01	124.63	10.80
	CR (%)	77	15.33	3.15	41.10	8.18
	OER (%)	77	10.49	4.93	45.90	6.21
	BA (Year)	77	11.72	4	28	6.01
	INF (%)	77	3.70	1.68	8.36	2.00

4.2 Panel Data Regression results

This study selects random effects as the best panel regression model because based on p-value of the Hausman test, the null hypothesis is accepted as p-value is higher than 5% as shown in the table 5, signifying that intercept differences between individuals can be accommodated by the error terms of each unit. Random effects use Generalized Least Square (GLS) estimator in its analysis (Greene, 2003). Consequently, to investigate the econometric problem, only multicollinearity test is conducted while heteroscedasticity test is not needed (Gujarati, 2004). As can be seen in table 4, all variables have VIF value under 10. Garson (2016) emphasizes that the maximum VIF for multicollinearity is value of 5. So, there is no multicollinearity statistically in this study.

Table 4. Variance Inflation Factors (VIF)

Variables	VIF
Bank size	2.1339
Loan ratio	1.4882
Capital ratio	1.9087
Operating expense ratio	1.3946
Bank age	2.2607
Inflation	1.3261

After examining validity of data, the next step is to see the significance of independent variables towards dependent variable. Based on results that can be seen in Table 5, four of six variables are found to be significant at 0.01. Also, the f-statistic is significant at 001, meaning that the equation proposed is reliable.

Table 5. Panel data regression analysis with random effects

Variables	Coefficient	t-Statistic
C	-18.2151	-5.5720***
BS	1.0071	5.4588***
LR	-0.0264	-1.5978
CR	0.2086	8.4225***
OER	0.1028	3.1110***
BA	-0.0148	-0.5737
INF	0.0870	2.4896***
Adj. R^2	: 0.4871	
F-Statistic	: 18.0935***	
Hausman	: 0.3313	
Total panel (unbalanced) observations	: 109	

*Dependent variable: ROAA, *** P < 0.01*

The first hypothesis of this study is that bank size has positive impact on ROA. Based on hypothesis test result econometrically, H1 in this study is accepted *p-value* is less than 0,05. This finding supports some previous studies conducted by Alsartawi (2019); Bukair and Rahman (2015); Ajili and Bouri (2018). The previous studies also reveal that there is positive relationship between bank size and ROA. Haron (1996) states that since large banks are assumed to enjoy economies of scale, they are able to produce their output or service more cheaply and efficiently than the small banks. So, the finding indicates that larger IBs are able to reduce the costs and risk in the financial market. As a result, larger IBs are more efficient than small IBs. The efficient IBs have opportunity to earn higher profit. Finally, the bank size has positive impact on financial performance of IB.

The second hypothesis is not accepted as *p-value* is more than 0,05. On the other hand, the result shows that the effect of loan ratio on ROAA is negative. The insignificant impact of loan ratio on ROAA is supported by some previous studies such as Hidayat and Abduh (2012); Al-Harbi (2019); Simpson and Kohers (2002); Ali and Khattak (2020). The insignificant result in the second hypothesis indicates that loan ratio does not influence financial performance of IBs. The negative effect indicates that higher loan ratio affects bank profit negatively.

One of causes that makes loan ratio insignificant on ROAA is inappropriate loan management conducted by some IBs in Indonesia. For example, in 2016-2017 Panin Dubai Islamic bank experienced loss because of inappropriate loan management. The bank disburse loan with big amount to wrong company. The company made fictitious credit so that bank cannot collect given debt. In 2018, the company makes bank loss at IDR 141 billion (Salih, 2019). In addition to that, Muamalat Bank, as the first IB in Indonesia, recently has the high non-performing finance ratio. Since 2015, this bank implemented inappropriate loan management or wrong business strategy. As a result, in 2019, the profit bank decreased by 94,1%. So, this condition may cause loan ratio insignificant on ROA for IBs in Indonesia (Saragih, 2019).

The acceptance of third hypothesis is in line with several previous studies, for example Al-Kayed *et al*. (2014); Athanasoglou *et al*. (2008); Zarrouk *et al*. (2016); Kosmidou (2008); Al-Harbi (2019). These previous studies showed that the capital ratio has positive impact on ROA significantly. The result of this hypothesis demonstrates that the higher capital ratio, the lower the need for external funding. Hence, the bank can reduce the cost of external funding. Furthermore, the well-capitalized bank is able to pursue business opportunities widely. Finally, the bank has opportunity to earn higher profit (Athanasoglou *et al*., 2008; Zarrouk *et al*., 2016).

The fourth hypothesis of this study is that the operating expense ratio has negative impact on ROA. Based on the test result statistically, there is positive relationship between operating expense ratio and ROAA significantly at 0.01, meaning that the hypothesis is not supported. This result of this study is consistent with previous studies such as Platonova et al. (2018); Vong and Chan (n.d.); Naceur (2003). This result may be caused by different bank characteristic and condition. As known previously, the structure funding of IBs in Turkey and Indonesia is dominated by participation account. This kind of account is more expensive than saving account for Islamic bank because the bank should give return to customer in certain period. So, there is high operating expense in Islamic bank. Furthermore, if the bank manages participation fund so well, the bank also has opportunity to earn profit. So, it is assumed that there is positive relationship between operating expense ratio and ROAA for Islamic banking in Turkey and Indonesia.

In Islam, there are *fiqh* principles about the relationship between expense, risk and profit. They are *al-ghunmu bil ghurmi* (profit goes with loss) and *al-kharaj bi al-dhaman* (Rewards goes with expense) (Ayub, 2007). So, it is normal if Islamic banks has positive relationship between expense and profit because expense, risk and profit is always together.

The fifth hypothesis of this study is that the bank age has impact on ROAA. As stated previously, there is different conclusion about the relationship between bank age and ROA. Some previous studies show that bank age has positive impact on ROA, and some previous studies shows that bank age has negative impact on ROA. Based on the test results statistically, H5 is rejected as *p-value* is higher than 0,05. The rejection of the fifth hypothesis is supported by Ajili and Bouri (2018); Zouari and Taktak (2014). These previous studies showed that there is no relationship between bank age and ROA. Bank age may influence ROAA negatively because sometime older bank is less efficient than new bank with respect to higher costs, older assets, less spending on research and development degenerated governance policies and large boards (Al-Malkawi & Pillai, 2018). For example, the first IB, Muamalat Bank, since 2015 has faced financing problem. It makes the profit of this bank decrease. So, it is identified that there is negative association between IB age and ROAA in Turkey and Indonesia.

Recently, the older bank and the new bank are competing to attract customer by improving their product and service quality. In this time, banking sector has developed digital banking in many countries including Turkey and Indonesia to provide fast and easy services to customers. So, the older bank is not guaranteed to have better performance, the success of the banks is depended on the creativity and innovation they have.

The last hypothesis of this study is that the inflation has positive impact on ROA. Based on the test result statistically, there is positive relationship between inflation and ROAA in Turkey and Indonesia. This hypothesis has *p-value* less than 0,05. The acceptance of hypothesis is in line with some previous studies such as Wasiuzzaman and Gunasegavan (2013); Al-Naseer Mohammed and Joriah Muhammed (2017); Izhar and Asutay (2007). These previous studies show that the inflation has positive impact significantly on ROA. The massive movement of inflation rate encourages banking sector to anticipate the inflation change. For example, based on data from

World Bank (2021) and (TCMB, 2021), the inflation in Turkey is over 10% since 2017. If the inflation rate is anticipated by bank's management, the bank can appropriately adjust the profit rate to increase revenues higher than costs. As a result, the inflation should have positive effect on profitability (Zarrouk *et al*., 2016). Hence, there is positive relationship between inflation and ROAA.

5. CONCLUSION

Having good financial performance is very important in banking sector as it demonstrates the quality of the bank such as serving and empowering society. Assessing IB performance based on conventional approach is not enough as it does not evaluate other important performance indicators in IB. This study analyses performance of IB using Islamic and conventional approach to have assessment more comprehensive. IBs in Turkey and Indonesia are used as sample for performance analysis as IBs in these countries show similar characteristic.

This study uses ROAA as performance indicator in IB. ROAA is included in classical method as it measures the performance of company based on earning. Further analysis is to see the factors affecting ROAA in IBs in Turkey and Indonesia using panel data analysis. Bank size, capital ratio, operating expense ratio, and inflation are found to have statistically significant impact on ROAA while loan ratio and bank age do not show significant effect on ROAA. Islamic bank with big asset size, capital ratio and operating expense ratio have more chance in generating profit. Meanwhile, in this study loan ratio is not found to be significant as some Islamic banks suffer high non-performing loan and mismanage in financing business sector. However, if the bank manage financing properly, the increase in financing might optimize to earn profit. Also, this study reveals that bank age does not determine to have better performance, meaning that older and experienced IB might have lower profit than newcomers. In this digital era, the innovation, creativity, and big impact on society are crucial to win the competition.

Theoretically, this study is expected to contribute to strengthening literature regarding financial performance analysis in Islamic bank. Practically, this study is expected to be used as foundation and reference for practitioners and related parties to develop Islamic bank financial performance in order to increase market share and make big impact on society.

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