THE INFLUENCE OF NON-PERFORMING FINANCING (NPF), CAPITAL ADEQUACY RATIO (CAR) AND FINANCING DEBT RATIO (FDR) ON RETURN ON EQUITY (ROE) AND ITS IMPLICATION ON MICRO SYARIA FINANCIAL INSTITUTION POLICY IN INDONESIA

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ABSTRACT

The aim of this research is to determine and analyze the influence of Non Performing Finance (NPF), Capital Adequacy Ratio (CAR) and Financing Debt Ratio (FDR) on Return On Equity (ROE) of Sharia Microfinance Institutions in Indonesia partially or simultaneously and their Implications for Policy LKMS in Indonesia. This type of research is verification. This research method is a quantitative research approach, statistical data analysis, with the aim of testing hypotheses. In accordance with the hypothesis formulated, the analysis used in this research is multiple linear regression analysis with least squares equations or OLS (Ordinary Least Square). In this research, the population is Sharia Microfinance Institutions which are proxied by Sharia People's Credit Banks totaling one hundred and sixty five throughout Indonesia which are registered with the Financial Services Authority (OJK). This research took NPF, CAR, FDR and ROE data in the form of monthly data from January 2010 to June 2017. The results showed that NPF, CAR and FDR were identified as partially significant in influencing LKMS performance. The variation in NPF, CAR and FDR on LKMS financial performance was 54.09% and the remainder was due to variations in other variables which were not addressed in the research. This means that the financial performance of LKMS is influenced by the high and low NPF, CAR and FDR ratios. Policy Implications for Sharia Microfinance Institutions in Indonesia requires an important role from the Government, in this case the authority is the OJK to prepare derivative regulations regarding actions taken by LKMS experiencing financial difficulties in order to improve their performance.

Keyword: - *Non-Performing Financing, Capital Adequacy Ratio, Financing Debt Ratio, Return On Equity, Islamic Microfinance.*

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1. INTRODUCTION

In the pursuit of fostering community empowerment, particularly within lower-middle-income communities and micro, small, and medium enterprises (MSMEs), the imperative of comprehensive support from financial institutions becomes evident. Overcoming these challenges necessitates the growth and development of non-bank financial institutions that engage in diverse business activities, business development, and community empowerment services. Whether established by the government or the community itself, these entities are collectively known as Microfinance Institutions (MI). The strategic role played by financial institutions in realizing national development goals underscores the crucial requirement for effective guidance and supervision [1]. This is essential to ensure that financial institutions in Indonesia operate efficiently, maintain financial health, and uphold fairness. This research assumes significance, given that financing stands as the linchpin in the repertoire of financial institutions' activities. Consequently, Sharia non-bank financial institutions must engage in rigorous supervision and meticulous analysis of financial reports. This approach is indispensable to sustain the financial well-being of institutions, preclude financing complications, and consistently uphold robust financial performance. By doing so, Sharia microfinance institutions can perpetuate the trust of stakeholders and contribute meaningfully to community development and economic growth.

Every company is obligated to demonstrate exceptional performance to endure the rigors of business competition. In Indonesia, the emergence of Sharia-compliant practices is becoming increasingly pronounced, exemplified by the proliferation of private microfinance institutions adhering to Islamic principles. An evaluation of the performance of these Microfinance Institutions (MFIs) is imperative, particularly through the lens of Return on Equity (ROE) for the period spanning 2012 to 2016. A notable downturn in ROE occurred in 2014, plummeting from 21.22% to 16.13%, and further decreasing to 14.66% in 2015. This trajectory signals a substantial setback in the financial performance of Sharia microfinance institutions, suggesting a lack of significant advancement during the specified period. Unraveling the factors contributing to this decline is critical for devising strategic interventions and fostering the sustainable growth of these institutions in alignment with Sharia principles [2].

The vitality of an institution stands as a paramount consideration. The assessment of institutional health encompasses a multifaceted analysis. Notably, the Return on Equity (ROE) serves as a pivotal metric, and its stagnant trajectory often signals non-performing financing as a key contributory factor. Historical evidence underscores the correlation between poor banking performance and economic crises, with elevated levels of Non-Performing Financing (NPF) emerging as a critical precursor. In particular, non-performing loans have proven to be a significant driver of suboptimal banking performance during periods of economic downturn. NPF, functioning as an essential gauge, succinctly reflects the overall health of a bank. The prevalence of high NPF, especially in the realm of non-performing loans, historically correlates with diminished banking performance [3]. Consequently, vigilant monitoring and proactive management of NPF become imperative to fortify the health and resilience of financial institutions, mitigating potential risks and fortifying the sector against adverse economic conditions.

As stipulated in BI Circular No. 9/24/DPbs, the assessment of bank health is intricately tied to the CAMELS framework, encompassing Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk. These factors offer a comprehensive lens through which the robustness of financial institutions is evaluated. The Capital aspect, a pivotal component, incorporates the Capital Adequacy Ratio (CAR). Asset Quality, another critical dimension, scrutinizes Non-Performing Financing (NPL). The Earnings facet encompasses multifaceted parameters, namely Return on Equity (ROE), Return on Assets, and the Operating Expenses to Operating Income (BOPO) ratio. Additionally, Liquidity, gauged by the Loan to Deposit Ratio (LDR), forms an integral part of the assessment process [4]. This research is motivated by a desire to scrutinize the financial performance of Sharia Microfinance Institutions, specifically focusing on Return on Equity (ROE). The anticipated outcome is the development of a conceptual framework elucidating the factors that significantly influence ROE. By delving into these intricacies, the study aspires to contribute valuable insights that can inform strategic decision-making within the context of Sharia Microfinance Institutions.

This research aims to analyze and describe the following aspects within the context of Sharia Microfinance Institutions in Indonesia:

- Problematic Financing (Non-Performing Finance): A detailed examination of the challenges associated with Non-Performing Finance within Sharia Microfinance Institutions.
- Capital Adequacy Ratio (CAR): A nuanced investigation into the Capital Adequacy Ratio, a critical metric reflecting the financial strength of Sharia Microfinance Institutions in Indonesia.
- Financing Debt Ratio (FDR): A thorough exploration of the Financing Debt Ratio, shedding light on the leverage and debt management practices within Sharia Microfinance Institutions.
- Return on Equity (ROE): A comprehensive analysis of Return on Equity, a key performance indicator assessing the profitability and efficiency of Sharia Microfinance Institutions.
- The Influence of NPF, CAR, and FDR on ROE: An examination of the individual and collective impacts of Non-Performing Finance, Capital Adequacy Ratio, and Financing Debt Ratio on Return on Equity in Sharia Microfinance Institutions. This includes both partial and simultaneous influences.

This research is fundamentally aimed at advancing the field of management science, specifically in the context of evaluating the financial performance of Sharia Microfinance Institutions. Through a focused exploration of distinct dimensions, the study seeks to deepen our comprehension of the intricate dynamics that shape the performance and sustainability of these institutions. By doing so, it endeavors to make substantive contributions to the broader discourse on management within the unique framework of Islamic finance [5]. The overarching aspiration is to provide valuable insights that not only enrich academic understanding but also offer practical implications for the effective management and enduring success of Sharia Microfinance Institutions in Indonesia.

The assessment of financial performance encompasses various dimensions, with one key metric being the Return On Equity (ROE) ratio. This ratio offers insights into a company's capacity to generate net profits utilizing its own capital, ultimately yielding returns available to both owners and investors. Highly coveted by shareholders, prospective investors, and management alike, ROE serves as a pivotal measure and indicator of shareholder value creation [6]. The significance lies in the correlation between a higher ROE ratio and an elevated company value. A comprehensive examination of research findings pertaining to financial performance, particularly evaluated through the lens of Return On Equity (ROE), is appended at the conclusion of this article, providing a nuanced exploration of the subject matter.

2. METHOD

The subject population under scrutiny in this research comprises Sharia Microfinance Institutions, specifically represented by Sharia People's Credit Banks, totaling one hundred and sixty-five entities dispersed across Indonesia. These institutions are duly registered with the Financial Services Authority (FSA). The research adopts a quantitative approach, characterized by its reliance on numerical data. As articulated by Sugiyono (2015:23), quantitative methods align with the positivist philosophy and are designed for investigating specific populations or samples. This approach involves the collection of data through designated research instruments, followed by quantitative/statistical analysis, with the primary objective of scrutinizing predetermined hypotheses.

The data incorporated in this research encompasses Non-Performing Financing (NPF), Capital Adequacy Ratio (CAR), Financing Debt Ratio (FDR), and Return On Equity (ROE) over an eight-year period. The dataset is aggregate in nature, comprised of monthly reports spanning from January 2010 to June 2017, totaling 90 months. This meticulous temporal coverage offers a robust foundation for a comprehensive examination of the dynamics within the realm of Sharia Microfinance Institutions.

3. RESULTS AND DISCUSSION

Microfinance Institutions (LKMs) represent specialized financial entities established with the primary objective of delivering business development and community empowerment services. These services encompass the provision of micro-scale loans or financing to both members and the broader community, effective management of savings, and the provision of non-profit-seeking business development consultancy. LKMs distinguish themselves by their commitment to fostering economic development and community empowerment, particularly among impoverished communities and low-income households engaged in microenterprise activities. One exemplar of successful Microfinance Institutions is the Grameen Bank in Bangladesh, founded by Muhammad Yunus. Renowned globally for its impactful initiatives, the Grameen Bank serves as a testament to the potential of MFIs in not only enhancing economic conditions but also empowering marginalized communities. Through its innovative approach, the Grameen Bank has played a pivotal role in improving financial inclusion and fostering sustainable economic growth among the economically disadvantaged.

In tandem with the burgeoning development of the Sharia economy in Indonesia, the proliferation of Sharia-based microfinance institutions is notable, both in terms of numerical expansion and enhanced performance. While much attention has been directed toward Sharia banking financial institutions within the realm of Sharia economics, it is imperative to underscore the equally crucial role played by Sharia microfinance institutions in propelling the economic development of Muslims in Indonesia, particularly in the context of poverty alleviation. This vital role stems from the fact that a substantial segment of the population, characterized by financial vulnerability, encounters barriers in accessing conventional financial services due to limited information literacy regarding financial institutions. As elucidated by Solikhah [2], Sharia Microfinance Institutions encompass entities such as Sharia People's Credit Banks (BPR) and Baitul Maal Wattaamwil (BMT). These institutions collectively serve as pivotal instruments in extending financial inclusivity, empowering marginalized communities, and fostering economic growth within the framework of Sharia principles.

Within the scope of this research, Sharia Microfinance Institutions are operationalized through the proxy of Sharia Credit Banks. The operational framework for Sharia-based Rural Credit Banks (BPRs) is delineated by the Decree of the Director of Bank Indonesia No. 32/36/KEP/DIR/1999, issued on 12 May 1999, specifically addressing the establishment and operations of Rural Credit Banks based on Sharia Principles [7]. This regulatory framework establishes Sharia BPRs as financial institutions akin to their conventional counterparts, with the distinction lying in their adherence to Sharia principles in all operational facets. A crucial aspect emphasized in this context is the imperative for Sharia BPRs to discern prevalent economic and social dynamics within the communities they serve. Understanding these economic and social symptoms is paramount, as it facilitates the formulation of Sharia BPR policies that are not only responsive but also aligned with the prevailing conditions in the community, ensuring a more marketable and socially relevant approach in the financial sector [8]. This strategic alignment enables Sharia BPRs to tailor their services in a manner that resonates with the diverse needs and circumstances of the community they aim to serve.

Table -1: Micro Sharia Financial Institution

Measurement	Standard Value	2012	2013	2014	2015	2016	Average
NPF	< 5%	6.15%	6.50%	7.89%	8.20%	8.63%	7.47%
CAR	≥ 11%	25.16%	22.08%	22.77%	21.47%	21.73%	22.64%
FDR	<100%	120.96%	120.93%	124.24%	120.06%	114.40%	120.12%
ROE	> 23%	20.54%	21.22%	16.13%	14.66%	16.18%	17.75%

Source: Secondary Data Processed, 2017

Table 1 presents the financial ratios of Sharia Microfinance Institutions spanning the years 2012 to 2016. A critical evaluation of the Non-Performing Financing (NPF) ratio reveals that the benchmark set by Bank Indonesia (BI) is below 5%. However, it is noteworthy that Sharia Microfinance Institutions consistently grapple with credit-related challenges, surpassing the stipulated threshold. Over the 5-year period, the average NPF ratio stands at 7.47%. This prolonged elevation is indicative of a concerning trend, portraying the NPF level at Sharia Microfinance Institutions as notably adverse. The escalating trajectory of NPF ratios each year, from 2012 to 2016, is indicative of a persistently deteriorating situation. In 2016, the NPF ratio peaked at 8.63%, propelling it to the 4th rank in Bank Indonesia's assessment of bank health. This positioning categorizes the institutions as being in poor condition, given that the NPF value exceeds the critical threshold of 6%. This analysis underscores the imperative for rigorous scrutiny and strategic interventions to address the persistent challenge of escalating Non-Performing Financing ratios within Sharia Microfinance Institutions during the specified period.

This observation underscores the suboptimal performance of credit activities within Sharia Microfinance Institutions. Certain scholars posit that the elevated Non-Performing Financing (NPF) is indicative of flawed decision-making processes [9]. The contention is that financial institutions may encounter challenges in obtaining pertinent and adequate information about the debtor's condition [10]. This inadequacy becomes particularly pronounced when analyzing matters encompassed by general requirements, especially in the scrutiny of financial statements. The repercussions of such limitations are multifaceted, affecting not only the accuracy of decision-making but also contributing to a reduction in bank capital. This reduction, in turn, exerts a cascading impact on the overall financial performance of Sharia Microfinance Institutions. Consequently, addressing these challenges in information acquisition and decision-making processes becomes imperative for enhancing the resilience and efficacy of credit activities within the context of Sharia Microfinance [11]. This critical evaluation lays the groundwork for strategic interventions aimed at fortifying financial institutions and mitigating the adverse effects on their financial performance.

The Capital Adequacy Ratio (CAR) functions as a crucial performance metric within the banking sector, gauging the sufficiency of capital to underpin assets susceptible to risks. As elucidated by Hutagaluh et al. [12], CAR emerges as a pivotal financial ratio, wherein the magnitude of a bank's capital exerts a decisive influence on the institution's capacity to execute its activities efficiently. Over a span of five years, the average Capital Adequacy Ratio in Sharia Microfinance Institutions reached 22.64%. This figure denotes the proportion of capital relative to risk-bearing assets, underscoring the financial robustness of these institutions. The positive correlation between CAR and Return On Equity (ROE) is evident in the analysis. As the CAR increases, the capital available to Sharia Microfinance Institutions expands, consequently enhancing the institutions' overall performance and operations. This augmentation, in turn, propels increased profitability for Sharia Microfinance Institutions, establishing a positive relationship between CAR and ROE. This observation accentuates the importance of maintaining a robust capital base for optimizing financial performance within the context of Sharia Microfinance [13], [14].

The Financing Debt Ratio (FDR) serves as a critical metric in gauging the efficacy of disbursed financing, indicative of the level of effectiveness in channeling funds to deficit parties. An ascending FDR is posited to correlate with increased bank profits, presuming that the institution can effectively channel financing. Over a five-year period, the FDR reached 120.12%. This figure underscores a noteworthy aspect concerning the limited income generation capacity of LKMS from the allocation of funds to parties facing deficits [15]. The elevated FDR prompts a critical evaluation of LKMS's ability to maximize income through the allocation of funds, revealing a perceived limitation in this aspect. Consequently, it is incumbent upon LKMS to institute enhancements in the management of third-party funds, thereby fortifying their capacity to generate income and ensuring the optimal utilization of funds in addressing the financial needs of deficit parties. This recognition of a limited income-generation potential accentuates the imperative for strategic improvements in the management of funds within the purview of LKMS.

Table -2: Micro Sharia Financial Institution Statistical Ratio

Dependent Variable: Y				
Method: Least Squares				
Sample (adjusted): 2010M01 2017M06				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.922.445	0.317851	1.234.053	0.0000
X1	-2.280.000	0.268492	-8.491.888	0.0000
X2	-1.089.336	0.133510	-8.159.208	0.0000
X3	-0.322605	0.085104	-3.790.712	0.0003
Weighted Statistic				
R-squared	0.540918	Mean dependent var		0.818772
Adjusted R-squared	0.524903	S.D. dependent var		0.023765
S.E. of regression	0.016380	Akaike info criterion		-5.342.035
Sum squared resid	0.023075	Schwarz criterion		-5.230.932
Log likelihood	2.443.916	Hannan-Quinn criter.		-5.297.232
F-statistic	3.377.677	Durbin-Watson stat		0.796650
Prob(F-statistic)	0.000000			
Unweighted Statistic				
R-squared	0.540918	Mean dependent var		0.818772
Sum squared resid	0.023075	Durbin-Watson stat		0.796650

Source: Secondary Data Processed by Eviews 2017

Table 2 presents the outcomes of the F-test, as depicted in the table above. The Prob (F-Statistic) value, registering at 0.000000, is notably smaller than the predetermined significance level of 0.05. This statistical result leads to the conclusion that the estimated regression model is well-suited for explicating the influence of Non-Performing Financing (NPF), Capital Adequacy Ratio (CAR), and Financing Debt Ratio (FDR) on the dependent variable Return On Equity (ROE). The exceedingly low probability value underscores a high level of statistical significance, affirming the robustness of the estimated regression model in capturing the relationships between the independent variables (NPF, CAR, FDR) and the dependent variable (ROE). This statistical validation supports the appropriateness of utilizing the model for further analysis and insights into the intricate dynamics governing the financial performance of the studied Sharia Microfinance Institutions.

The Prob value (p-value) calculated for the independent variable Non-Performing Financing (NPF) (X1) is recorded at 0.0000, which is smaller than the significance level of 0.05. This signifies that the independent variable NPF (X1) exerts a statistically significant impact on the dependent variable Return On Equity (ROE) (Y) at the 95% confidence level. In other words, NPF significantly influences ROE at a 5% significance level. Similarly, the independent variable Capital Adequacy Ratio (CAR) (X2) demonstrates a significant effect on the dependent variable ROE (Y). The prob. t value of 0.0000 is smaller than the 0.05 significance level, confirming the statistical significance of the impact of CAR on ROE at the 95% confidence level. Likewise, the Financing Debt Ratio (FDR) (X3) exhibits a substantial impact on ROE (Y). The prob. t value of 0.0003 is smaller than the 0.05 significance level, indicating that FDR significantly influences ROE at the 95% confidence level. This statistical analysis underscores the robustness of the relationships between individual independent variables (NPF, CAR, FDR) and the dependent variable ROE, supporting the assertion of their significant effects within the studied context [16].

The R-square value in the presented table stands at 0.540918, indicating that approximately 54.09% of the variation in the Return On Equity (ROE) variable can be attributed to the combined influence of the Non-Performing Financing (NPF) (X1), Capital Adequacy Ratio (CAR) (X2), and Financing Debt Ratio (FDR) (X3) variables. This implies that more than half of the observed variability in ROE is accounted for by NPF, CAR, and FDR, collectively. Conversely, the remaining 45.91% of the variability in ROE is influenced by factors not incorporated into the model. These unaccounted-for variables contribute to the overall complexity and multifaceted nature of the determinants shaping Return On Equity in the context under investigation. This acknowledgment underscores the importance of considering additional variables beyond NPF, CAR, and FDR for a more comprehensive understanding of the factors influencing ROE within the studied framework.

The regression coefficient for Non-Performing Financing (NPF) (X1) is observed as negative, indicating an inverse relationship with Return On Equity (ROE) (Y). Specifically, as the percentage of Non-Performing Financing decreases, the ROE percentage increases, and conversely, an increase in the NPF percentage corresponds to a decrease in the ROE percentage. Quantitatively, a 1% decrease in the NPF percentage is associated with a substantial increase in ROE by 2,280%, underscoring the sensitivity of ROE to improvements in Non-Performing Financing. Conversely, a 1% increase in the NPF percentage is linked to a significant reduction in ROE by 2,280%. This numeric insight elucidates the magnitude of the impact that changes in Non-Performing Financing levels can exert on Return On Equity within the model.

The regression coefficient for Capital Adequacy Ratio (CAR) (X2) is observed as negative, signifying an inverse correlation with Return On Equity (ROE) (Y). Specifically, a decrease in the CAR percentage is associated with an increase in the ROE percentage, while an increase in the CAR percentage corresponds to a decrease in the ROE percentage. Quantitatively, a 1% decrease in the CAR percentage is linked to a substantial increase in ROE by 1,089%, highlighting the sensitivity of ROE to reductions in Capital Adequacy Ratio. Conversely, a 1% increase in the CAR percentage is associated with a significant reduction in ROE by 1,089%. This numerical insight underscores the magnitude of the influence that changes in Capital Adequacy Ratio levels can have on Return On Equity within the model.

The regression coefficient for Financing Debt Ratio (FDR) (X3) is observed as negative, indicating an inverse relationship with Return On Equity (ROE) (Y). Specifically, a decrease in the FDR percentage is associated with an increase in the ROE percentage, while an increase in the FDR percentage corresponds to a decrease in the ROE percentage. Quantitatively, a 1% decrease in the FDR percentage is linked to a modest increase in ROE by 0.322605%, underscoring the nuanced impact of Financing Debt Ratio on ROE. Conversely, a 1% increase in the FDR percentage is associated with a slight reduction in ROE by 0.322605%. This numerical insight sheds light on the sensitivity of ROE to fluctuations in Financing Debt Ratio within the model.

The policy implications for Sharia Microfinance Institutions (LKMS) in Indonesia necessitate a crucial role from the government, specifically vested in the regulatory authority of OJK. It is imperative for OJK to formulate derivative regulations that address the challenges faced by LKMS grappling with financial difficulties, with the overarching goal of fostering improved performance. The envisioned trajectory for Sharia microfinance involves the establishment of sustainable local financial institutions. These institutions, ideally, would act as conduits for collecting funds from the local populace, subsequently reinvesting them in the form of loans within the same community. This localized financial circulation serves as a catalyst for community empowerment and economic development. The envisioned model aligns with the broader objectives of Sharia microfinance, aiming to establish resilient financial structures that cater to the unique needs of specific regions, thereby contributing to the overall financial well-being and prosperity of the local communities.

4. CONCLUSIONS

The analysis reveals a relatively stable Return On Equity (ROE) value for Sharia Microfinance Institutions (LKMS), consistently hovering around 1 (one). This stability underscores the effective utilization of company equity in generating income, indicative of a sound financial strategy within these institutions. This resilience suggests that Sharia Microfinance Institutions (LKMS) demonstrate proficiency in leveraging equity for business development, potentially expanding their operations through the utilization of securities instruments. Contrastingly, the performance of Non-Performing Financing (NPF) in Sharia Microfinance Institutions (LKMS) raises concerns as the NPF exceeds the threshold of 5%. Notably, in 2018, the NPF surged to 11.56%, signaling heightened risk in the quality of financing disseminated by Sharia Microfinance Institutions (LKMS). This elevated NPF level suggests a substantial degree of risk associated with customer repayments, necessitating careful consideration and strategic interventions to mitigate potential adverse effects on the financial health of these institutions and to sustainably support their clientele.

The Capital Adequacy Ratio (CAR) in Sharia Microfinance Institutions (LKMS) across Indonesia exhibits commendable stability, consistently averaging above 20%. This resilience signifies the institution's robust capacity to absorb risks associated with potentially hazardous credit and productive assets. Conversely, the Financing Debt Ratio (FDR) performance is marked by a level surpassing 110%, indicating a challenge in the effective channeling of financing by LKMS.In synthesis, the research findings and subsequent discussion lead to the conclusion that, both individually and collectively, the variables Non-Performing Financing (NPF), Capital Adequacy Ratio (CAR), and Financing Debt Ratio (FDR) exert a significant impact on Return On Equity (ROE), collectively contributing to 54.09%. Nevertheless, a substantial portion, accounting for 45.91%, remains influenced by variables beyond the scope of the current model. This underscores the complexity of factors influencing ROE in Sharia Microfinance Institutions and highlights the need for further exploration and consideration of additional variables to comprehensively understand the dynamics at play.

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