# CHAPTER I

# INTRODUCTION

## A. Background

Banks are known as financial institutions whose main activities are accepting current accounts, savings and deposits. Then the bank is also known as a place to borrow money (credit). Banking has a very important role in achieving national goals related to equitable distribution and improvement of people's living standards and supporting the running of the economy. In view of their function as a means of transmitting monetary policy, intermediary institutions, and providers of payment transactions, banks have been forced to implement a bank soundness rating system, thereby becoming more competitive. In addition, because banks are an industry that relies on public trust in their business activities, bank performance and health need to be maintained (Wangi & Ramantha, 2017).

The banking system in Indonesia itself consists of conventional commercial banks, which are then followed by Islamic commercial banks. Broadly speaking, conventional commercial banks and Islamic commercial banks have the same function, the difference lies in the interest and profit sharing system. Where the conventional commercial banks apply the interest system in obtaining profits, while the Islamic commercial banks apply the profit sharing system. The existence of Sharia banks in Indonesia is a new solution for people who want a banking system that is in accordance with Islamic law.

Sharia banks were established with the aim of promoting and developing the application of Islamic principles, Sharia and traditions into financial transactions and banking and other related businesses. The main principle followed by Sharia banks is the prohibition of usury in various forms of transactions, conducting business and trading activities based on obtaining legal profits and giving zakat (Arifin, 2002).

The development of these Islamic financial institutions is relatively fast, and one reason is due to the strong belief among the Muslim community that conventional banking contains usury which is prohibited by Islam (Arifin, 2002). For approximately six years of operation, except for Law no. 7/1992 and Government Regulation No. 72/1992, there are practically no other laws and regulations that support the operation of Sharia banking. This forces, Sharia banking to adjust its products to the positive laws in force in Indonesia, which are interest-based/conventional. As a result, the inherent characteristics of sharia are disguised and Sharia banks in Indonesia appear like conventional banks (Arifin, 2002).

With the promulgation of Law No.10 / 1998 on Amendments to Law no. 7/1992 concerning Banking, the Sharia Banking System is strictly placed as part of the National Banking System. It is hoped that this legal instrument will provide a stronger legal basis and greater opportunities for the development of Sharia banking in Indonesia. Following is the number of Islamic financial institutions in Indonesia:

**Table 1.1**

**Number of Islamic Financial Institutions in Indonesia**

| Name | Total |
|---|---|
| Sharia Commercial Bank | 14 |
| Sharia Business Unit | 34 |
| BPR Syariah | 162 |

Source: www.ojk.go.id

Given the important role of Sharia banks in Indonesia, it is necessary to improve the performance of Sharia banks so that banks with Islamic principles remain healthy and efficient. In its operational activities, the bank has the main objective, namely to achieve the maximum level of profitability. Profitability has an important meaning in maintaining business continuity in the long term, because profitability shows whether the business entity has good prospects in the future. Banks must also try to keep profitability, stable and even increase in order to fulfill obligations to stakeholders, increase the attractiveness of investors in investing and increase public confidence in saving the excess funds they have in the bank.

In this study, profitability is measured by Return on Assets (ROA). The reason for choosing ROA as a profitability ratio is because ROA can measure the company's ability to generate profits by using the company's assets after adjusting for the costs incurred to fund these assets (Wityasari, 2014). And the variables that are thought to affect the profitability (ROA) of Sharia banking are

Capital Adequacy Ratio (CAR), Non-Performing Financing (NPF), Net Interest Margin (NIM), Operational Costs to Operational Income (BOPO), Third Party Funds (DPK), and Financing to Deposit Ratio (FDR) (Ariyanti, 2017).

The following is a table of profitability developments at Sharia Banks in Indonesia 2017-2019:

**Table 1.2**

**Development of Profitability in Islamic Commercial Banks for the 2017-2019 Period**

| Year | ROA (%) |
|---|---|
| 2017 | 0,63 |
| 2018 | 1,28 |
| 2019 | 1,73 |

Source: Sharia Banking Statistics, Financial Services Authority 2017-2019, Thursday 1 October 2020 at 22.54 WIB

Capital Adequacy Ratio (CAR) is an important factor for a company to operate. Banks in extending credit to the public also need capital. Bank capital must also be used to guard against possible risks, including risks arising from credit itself. Capital Adequacy Ratio (CAR) or capital adequacy ratio is the ratio of bank performance to measure the capital adequacy of the bank to support assets that contain or generate risk (Dendawijaya, 2015).

The results of the research conducted by Sukmana, et al., 2016), and (Yusuf, and Surjaatmadja, 2018) which is clarified the significant positive influence between the relationship of capital adequacy ratio (CAR) and profitability (ROA). Where to get an increase in profits using ROA analysis must also be accompanied by increasing capital adequacy (CAR). In contrast to the research conducted by (Warsa & Mustanda, 2016) which states that CAR has a positive and insignificant effect on financial performance (ROA). This means that the higher the level of capital adequacy (CAR) of a bank is not a measure of the success of bank management in gaining high profits. Other studies conducted (Prasetyo & Darmayanti, 2015) and (Sari & Setyowati, 2017) state that CAR has a negative and insignificant effect on ROA. Which means, the adequacy of capital in banking companies is not able to increase its profitability. With the differences in research results found, the authors are interested in conducting further research on the effect of CAR on profitability.

BOPO is a group of ratios that measures the operational efficiency and effectiveness of a company by comparing one another which aims to measure the ability of operating income to cover operational costs. Based on research from Aziz (2016 and Susanto (2016) which states that Operational Costs on Operating Income (BOPO) have a negative but insignificant effect on Return on Assets (ROA). However, it is not in line with research from Ariyanti (2017) and Harianto (2017) which states that Operational Costs on Operating Income (BOPO) have a negative and significant effect on Return on Assets (ROA). The results of the study, according to Zulfikar (2014) that Operational Costs on

Operational Income (BOPO) have a positive and significant effect on Return on Assets (ROA).

Financing to Deposit Ratio (FDR) can be used to measure the level of effectiveness of disbursed financing, so that if the FDR ratio increases, bank profits will also increase with the assumption that banks can channel financing effectively (Nurvarida, 2017). Research results from Harianto (2017), Ariyanti (2017) and Pangestika (2018) which state that the Financing to Deposit Ratio (FDR) has no significant effect on Return on Assets (ROA). Different results were found by Suyono (2005: 61) and Christiano (2014) which stated that the Financing to Deposit Ratio (FDR) had a positive and significant effect on Return on Assets (ROA).

This research was conducted to find out about whether there is an effect of Cash Adequacy Ratio and operating ratio on profitability in Indonesian sharia bank from 2017 to 2019 through liquidity risk as moderating variable. This research is a development from previous research conducted by Yusuf M. (2018) which is titled "Analysis of financial performance on profitability with non-performance financing as variable moderation (Study at sharia commercial bank in Indonesia period 2012-2016)". That showed about, there is significant effect of CAR and FDR on profitability. This confirms that cash adequacy ratio and financing to deposit ratio have a positive effect on profitability and NPF as a variable that moderates the relationship between FDR on ROA is considered capable of moderating. Changes and additions made in this study, the period of times in this research is years from 2017 to 2019, so that it will also focus on the current financial performance of Indonesian sharia banks, in case of the development of Sharia Commercial Bank in Indonesia is very rapid and is growing well even though it is running slowly. This is evidenced by the growth of assets every year. In 2017 the total assets of Sharia Commercial Bank in Indonesia amounted to Rp 288,027 billion. Then in December 2018 the total assets of Sharia Commercial Bank became Rp 316,691 billion. Third-party funds also grew 19.2 percent, from Rp 238,393 billion in December 2017, to Rp 257,606 billion in December 2018. The sharia commercial bank data is based on Islamic banking statistics in December 2018 (Otoritas Jasa Keuangan, 2019). Another addition in this research is liquidity risk as a moderating variable.

Based on the above background, the researchers will raise the research entitled **"The Effect of Capital Adequacy Ratio and Operating Ratio on Profitability with Liquidity Risk as a Moderating Variable (Study at Indonesian Sharia Banks in Period of 2017-2019)".** To be able to complete the study, this study will be based on previous studies and updates that will be researched by current researchers.

## B. Research Problem

1. Does capital adequacy ratio have a positive effect on the profitability?
2. Does operating ratio have a positive effect on the profitability?
3. Is liquidity risk proven to be a moderating variable between the effect of capital adequacy ratio on the profitability?

4. Is liquidity risk proven to be a moderation variable between the effect of operating ratio on the profitability?

## C. Research Objectives

The objective of this research is to obtain the empirical study of:

1. Capital adequacy ratio has positive effects to the Profitability.
2. Operating ratio has positive affects to the Profitability.
3. Capital adequacy ratio has positive affect to the Profitability through liquidity risk.
4. Operating ratio has positive affect to the Profitability through liquidity risk.

## D. Benefits of Research

1. Theoretically
    a. To grow and increase the author's insight and knowledge in depth on the issues examined.
    b. As a reference for further research on this issue.
2. Practically

This research can be used as a material for Sharia banking studies in improving its financial performance.