



Impact of Non-Performing Financing and Capital Adequacy on Profit Growth in Islamic Commercial Banks

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Abstract

Purpose – This study aims to determine the effect of Non-Performing Financing and capital adequacy on profit growth partially and simultaneously. The population in this study was 14 Islamic commercial banks, with a sample of 12 Islamic commercial banks.

Methodology – This type of research employs a quantitative approach with an explanatory research design, utilizing a data analysis methodology that includes panel data regression analysis, assisted by EViews analysis.

Findings – The results of this study indicate that partially non-performing financing has a positive and significant impact on profit growth, while capital adequacy does not significantly affect profit growth. Simultaneously, non-performing financing and capital adequacy affect profit growth.

Implication – The implication is that Islamic commercial banks need to focus more on managing non-performing financing due to its significant impact on profit growth, despite its positive influence. In addition, although capital adequacy does not have a partial effect, bank management must still consider both factors simultaneously to ensure stability and sustainable profit growth.

Originality – The originality of this study lies in its specific focus on Islamic commercial banks in Indonesia in the period 2020-2024, a period that includes the impact of the pandemic and economic recovery, as well as the use of panel data analysis to simultaneously explore the effect of non-performing financing and capital adequacy on profit growth.

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1. Introduction

As is well known, banking is one of the key agents of state development, primarily due to its primary function as a financial intermediary institution, which collects public funds in the form of deposits and distributes them to the community in the form of credit or financing. This function is a concern for Islamic banking, in addition to its other functions as an institution providing financial services. The growth of Islamic banking in Indonesia is experiencing significant growth, as reported by Bank Indonesia, which states that the development of Islamic banking is growing rapidly (Ridwansyah et al., 2020). An Islamic Bank is a financial institution that conducts business activities and banking operations in accordance with Sharia principles. The Islamic Bank has two



business groups: Sharia Commercial Banks and Sharia Rural Banks. The business activities of an Islamic bank are based on the principle of muamalat in Islam, which refers to the provisions of the Quran and the Hadith (Ridwansyah et al., 2021).

Islamic banking is regulated by the Islamic Financial Accounting Standards, which provide detailed provisions and components of sharia-based banking. With these standards, financial statements are expected to provide relevant and credible information. This accounting standard is also used by users of financial statements, such as investors, creditors, governments, and the public, as a reference for understanding and analyzing financial statements, enabling them to make informed decisions (Suryanto & Ridwansyah, 2016). Financial management in banking is considered to play a crucial role because it not only impacts the sustainability and profitability of business activities, but also affects all individuals involved in the business. Financial managers are expected to perform their financial functions effectively, enabling the company to conduct its operational activities more efficiently and effectively (Ridwansyah et al., 2024). The Financial Services Authority stated that Indonesian Islamic banking continues to demonstrate growth in its development. In general, a bank is considered a company because its activities are established to generate optimal profits. The company's assets are invested in a project designed to create a profit. The expected profit from the investment is referred to as the profit target (Sugiri, 2009).

Profit is crucial for the bank's survival and business growth. To generate a profit, a bank must effectively manage its assets in a profitable venture. Profit is an increase in economic benefits during one accounting period in the form of income or additional activities, or a decrease in liabilities resulting in a rise in equity that does not come from investment contributions (Nurmalia, 2011). Profit is necessary for the company to sustain its existence, and it is expected that the profits obtained will increase from year to year. Therefore, for the company to continue existing in the economy, it is likely that its corporate profits must always grow. However, the increase in profit cannot always be ascertained; it could be that this year's profit decreased, but next year's profit could have increased. Because profit growth cannot be ascertained, it requires the existence of an analysis that can predict whether the company's profit growth will fall or rise (Siringoringo et al., 2022).

Increased profits can illustrate that banking companies periodically experience significant improvements in managing their operations. In addition, investors will participate in decision-making because they see that the profits from the banking company have increased significantly. This is because good profit growth in banking companies will lure investors to invest. The more investors the banking company has, the more capital it will obtain, which can later be allocated for business expansion, thereby increasing profit growth (Devina et al., 2024). The rate of profit growth serves as a benchmark for banks, particularly Islamic banks, to assess their ability to manage and generate profits from business activities. This is undoubtedly related to the performance that the Islamic bank will produce, whether the bank's performance is good or not. Any economic activity or business is certainly focused on making a profit. The bank's ability to achieve profit targets is one of the key performance assessments used for decision-making. Good profit growth indicates that the company has strong financials, which will ultimately increase its value, as the amount of profits to be paid in the future depends on the company's current condition (Lestari & Ruliaty, 2019).

When analyzing and assessing financial conditions, financial analysis tools are necessary; one of the most commonly used financial analysis tools is the financial ratio. Financial ratios help identify a company's financial strengths and weaknesses, allowing investors to assess its current and past financial condition and operating results. These ratios also serve as a guideline for investors regarding past and future performance, which can be utilized in making informed investment decisions (Dewi et al., 2024). Financial ratios that can measure or predict profit growth include Non-Performing Financing Ratios and Capital Adequacy Ratios. In banking, there are various forms of banking business, including the provision of financing. In financing activities carried out by Islamic commercial banks, there is a potential emergence of problematic financing, commonly referred to in Islamic banking terms as Non-Performing Finance (Novalista et al., 2024). Problematic financing is financing that, in return, faces difficulties due to intentional factors or the

inability of financing customers to repay loans. The size of the complicated financing of an Islamic Bank depends on the management of the financing funds disbursed (Anisa, 2015). The higher the value of problem financing, the lower the bank's income level, and the bank's financial sustainability ratio will also decrease (Fortuna et al., 2016).

The capital of a bank is crucial for operational activities and to support the bank's development. Capital adequacy is a critical component of assessing a bank's financial health. If a bank has been declared unhealthy due to a lack of capital, its operations will be disrupted, leading to a decline in performance (Nurmalia et al., 2021). The higher this ratio, the better the performance of a bank, but if the value of the CAR decreases, it results in a decrease in the ability of the bank to disburse credit, which ultimately results in the bank losing its ability to obtain maximum profit in its operating activities (Ain, 2021). The determination of CAR serves as a benchmark to assess the capital ratio, aiming to maintain profitability based on its relationship with potential risk levels. The results from calculating the CAR ratio will describe several assets that may pose risks to the bank's operational activities. The CAR is measured as the ratio of own capital to risk-weighted assets (ATMR). (Taufik et al., 2018).

Bank Indonesia, in PBI No. 13/1/2011, established a bank health assessment system called the RGEC method. RGEC stands for Risk, Profile, Good Corporate Governance, Earnings, and Capital (PBI, 2011). RGEC replaced the earlier assessment method, CAMEL. In this study, the financial ratios used are NPF as a proxy for troubled financing and CAR as a proxy for capital adequacy. NPF is a problem loan in the form of classified loans. According to Bank Indonesia, the acceptable NPF tolerance limit is 5% per bank. Islamic banks are required to keep NPF levels within this threshold to maintain good financial health (Indriani et al., 2023). CAR is a bank performance ratio used to measure capital adequacy, with the bank's standard efficient value being 8% (Darmayani, 2024).

Table 1. Development of NPF, CAR, and Profit growth

Year	NPF (%)	CAR (%)	Profit Growth (%)
2020	3,13	21,64	13,97
2021	2,59	25,71	16,95
2022	2,35	26,28	46,84
2023	2,10	25,41	8,06
2024	2,08	25,30	23,84

Sources: www.ojk.go.id 2025

Based on Table 1, analyzing the annual data of Sharia commercial banks, it seems that the NPF level from 2020 to 2024 is healthy because it stays below Bank Indonesia's assessment figures and hasn't risen significantly. In 2020, the NPF was 3.13% and dropped to 2.08% by 2024. Usually, when NPF increases, profit growth decreases, and when NPF decreases, profit growth should rise; however, this study does not support that theory, as in 2023, when NPF went down, profit growth also fell. At the level of CAR from 2020 to 2024, it is in a healthy condition because it exceeds Bank Indonesia's assessment figures. However, it has not experienced a significant increase compared to the average. In 2020, the value of CAR increased by 21.64% and by 2022, it had risen to 26.28%. From 2023 to 2024, it again decreased to 25.30%. When the CAR has increased, so has profit growth. Conversely, when the CAR has decreased, profit growth will decrease. However, in this study, the findings do not align with the theoretical model, which predicts that in 2024, when CAR decreased, profit growth would increase.

The economic conditions that occurred, especially in 2020, experienced slight changes due to the COVID-19 pandemic (Pratomo & Ramdani, 2021). This led to a reduction in the allocation of new capital due to the weakening purchasing power of the people. On the other hand, the debtor's credit reputation also decreases, increasing the risk of financing inefficiency (Sekar Melati,

2023). According to the Financial Services Authority, profitability decreased during the COVID-19 pandemic in 2020. Even so, in 2021, when the new Normal is implemented until 2024, the profitability of Islamic banks is still well maintained. This is reflected in the ratio of cars that are still increasing and well above the threshold. In addition, Islamic banking NPF remains in fairly good condition (OJK, 2024). This proves that the performance of Islamic banks can still be maintained and has not experienced an increase in problem financing and a considerable decrease in capital adequacy. Even so, many must be considered by Islamic banks in order to reduce all possible risks.

Some previous research suggests that the results of his study indicate whether there is an influence of the ratio of financial performance on profit growth. However, these results indicate a difference or research gap. For example, the study Marina (2018) explained that Non-Performing Financing (NPF) has a negative and significant effect on profit growth. Jati (2018) explains that Non-Performing Financing (NPF) has a positive and significant impact on profit growth. Jati (2018) explained that the Capital Adequacy ratio (CAR) has a significant positive effect on profit growth. Research has shown that the Capital Adequacy Ratio (CAR) has no significant impact on profit growth.

Although there have been many studies that examine the factors that affect bank profit growth, a specific research gap arises in the context of Islamic commercial banks related to the interaction between problem financing (NPF) and capital adequacy (CAR), primarily using panel data analysis in the very recent period of 2020-2024. Previous research has often focused on conventional banks or used different data periods and has not fully reflected the impact of post-pandemic economic conditions and the dynamics of recent Sharia regulation on profitability. Empirically, there is still inconsistency of results regarding the direction and significance of the influence of NPF and CAR on Islamic commercial banks profit growth; some studies found NPF to have a significant adverse effect while others did not, as well as CAR which sometimes showed a strong positive relationship and at other times was weak, thus requiring re-testing to obtain more valid and current conclusions in the Indonesian Islamic banking sector.

The context of research focusing on the effect of Non-Performing Financing (NPF) and Capital Adequacy on profit growth at Islamic commercial banks (BUS) for the 2020-2024 period has a significant novelty, especially in highlighting the dynamics of Islamic banking post-COVID-19 pandemic and amid the latest global economic challenges. Although the topics of NPF, CAR, and general profitability are examined, this study presents the novelty of, among others, the 2020-2024 analysis period which fully covers the period of economic recovery from the pandemic and the beginning of the consolidation phase of Islamic banking in Indonesia, allowing the identification of more relevant and up-to-date trends than previous studies that often ended before 2020, both focus exclusively on Islamic commercial banks (BUS), which have different operational and risk characteristics than conventional banks, making it a specific and crucial study in the context of the stability and development of Islamic banking and the use of panel data that provides more efficient and accurate estimation results by taking into account heterogeneity between buses, resulting in more in-depth findings on how the management of financing risk (NPF) and capital (CAR), which simultaneously affects the ability of buses to achieve sustainable profit growth in the new normal era.

The purpose of this study was to test and empirically analyze the simultaneous and partial effects of the independent variables, namely Non-Performing Financing (NPF) and Capital Adequacy Ratio (CAR), on the dependent variable of profit growth in Islamic commercial banks in Indonesia during the period 2020-2024 using the panel data analysis method. Specifically, this study aims to measure the extent to which fluctuations in NPF and CAR can explain changes or increases in profits achieved by Islamic commercial banks, thereby making a practical contribution to understanding the fundamental factors that affect the profitability performance of the Islamic banking industry.

2. Literature Review

2.1 Signalling Theory

Signaling Theory was developed by Michael Spence in 1973. It describes how the sender of information can transmit a signal to the receiver of information, conveying useful information from the owner of the information. According to signal theory, management uses signals to reduce information asymmetry. Given that it comprises details, notes, and images of the company from both the past and the future, this information is crucial for investors and stakeholders (Mahendra & Daljono, 2023).

Signaling theory refers to actions taken by a company's management to provide clues to investors about their views on the company's prospects. This theory explains the reasons behind the company's urge to communicate or convey information related to financial statements to external parties. This impulse arises due to an information imbalance between the company's management and external parties. The company or its management has more information about the company's operations and prospects than external parties, such as investors, creditors, underwriters, and other users of information. To address this issue and mitigate information asymmetry, companies can provide transparent and credible signals to outside parties through their financial statements, which contain accurate financial information. This will provide certainty regarding the company's future sustainability prospects, which can serve as a basis for informed decision-making. The signal can be good financial performance, which is reflected in the reported financial health ratios (Ridho & Aprilia, 2024).

2.2 Non-Performing Financing

Problem financing or NPF is a picture of the situation, where the loan repayment agreement is at risk of failure, and even tends to / experience a potential loss (potential loss). The existence of problematic financing in high amounts will cause difficulties and reduce the health of the bank concerned (Utami & Utami, 2021). Problem financing refers to the portion of the funding provided by the bank that cannot be collected back in accordance with a predetermined schedule. This financing is considered problematic because the customer has difficulty or an inability to pay off their obligations. A high NPF level indicates a problem in the asset quality of a bank, which can be caused by various factors such as deteriorating economic conditions, errors in credit scoring, or changes in the financial condition of customers. NPFS have significant implications for the financial performance of banks, as they can reduce profitability and increase credit risk (Nabilah, 2024).

NPF is a ratio that describes the collectability of financing categories, including those classified as substandard, doubtful, and non-performing, as per the criteria. If the NPF is not within reasonable limits, the bank will lose the opportunity to generate income from loans to customers, thereby reducing its profit and adversely affecting profitability. Problematic financing in large quantities will reduce the operational capacity of these banks. If the decline in funding and profitability is so severe that it affects the bank's liquidity, solvency, and profitability, the trust of depositors in the bank will decrease (Azmy, 2018).

The high ratio of Non-Performing Financing (NPF) in Islamic banks can be interpreted as a negative signal to the market and investors, indicating that the bank's financing risk management is ineffective, which in turn can trigger a decline in confidence and stock valuation. Instead, the bank's management's efforts to transparently disclose NPF improvement strategies or maintain consistently low NPFS serve as positive signals, indicating operational health and future profit prospects, which may attract capital and improve the bank's reputation.

2.3 Capital Adequacy

Capital is a crucial factor in the development and progress of a bank while maintaining public trust. Every asset creation, in addition to potentially generating profits, also has the potential to cause risk. Therefore, capital must also be used to maintain the possibility of risk and loss on assets and investments, especially those from third-party funds or the public. Increasing the role of assets

as profit generators must be accompanied by a simultaneous consideration of the risks that may arise, to protect the interests of fund owners. If the bank is already operating, then capital is one of the factors that is very important for business development and accommodating the risk of loss (Nurkhalifa et al., 2021).

Capital is essential for the progressive development of banks, as well as for maintaining public confidence. Bank Indonesia has established standard banking criteria, one of which is maintaining substantial capital to create a stable financial system that encourages national economic growth. Capital adequacy is a banking regulation that sets a framework for how banks and depository institutions should handle their capital. This capital adequacy refers to a bank's ability to maintain sufficient capital to cover the risk of losses that may arise from investing funds in productive assets that carry risks, as well as for financing fixed assets and investments (Setiawati et al., 2017).

The level of capital adequacy is a crucial factor for the bank in the context of business development, as it enables the bank to accommodate losses and reflect its financial health, thereby maintaining public confidence in banking and protecting public funds at the bank concerned (Rustendi, 2019). CAR is a ratio or comparison between a bank's capital and its risk-weighted assets (RWA), which affects the bank's bad loans. If the CAR decreases, bad debts will increase, resulting in a decrease in company capital and a reduction in annual profit (Ridwansyah et al., 2021).

In the context of signaling Theory, Islamic commercial banks can use a high level of Capital Adequacy Ratio (CAR) as a signal to the market, especially customers, investors, and regulators, that the bank has strong financial stability, prudent risk management, and adequate ability to absorb potential future losses. The high CAR, which indicates capital adequacy exceeding the regulatory minimum, serves as a positive signal that can increase public confidence, attract funding, and potentially lower the cost of capital, as banks are considered to have a lower risk of bankruptcy.

2.4 Profit Growth

Profit is the profit or excess income obtained by an organization or company from the initial capital invested. According to Istiqomah (2023) profit is an essential figure in the financial statements for the following reasons: profit is the basis for calculating taxes, guidelines in determining investment policies and decision making, the basis for forecasting profits and other economic events of the company in the future, the basis for calculating and assessing efficiency in running the company, and as a basis for determining the company's achievements or performance. A company is generally evaluated based on its ability to manage profit and is often used to determine whether investors should invest in the company.

Profit growth refers to the percentage increase in profits that a company can generate in the form of net income (Alpionita & Kasmawati, 2020). The definition of profit growth is the percentage increase in profits that a company generates in the form of net income. The existence of profit growth in a company can indicate that management has been successful in effectively and efficiently managing the company's resources. A company in a given year could have experienced a relatively rapid profit growth compared to the average company. However, for the next year, the company could have decreased profits.

Based on this definition, it can be explained that profit growth indicates how the percentage difference in profit increase in a company reflects the company's good performance condition. If the economic conditions are generally good, the company's growth is also good. According to signaling Theory, management companies with strong profit growth prospects tend to send positive signals to the market, such as through expansionary investment policy announcements or dividend increases, to reduce information asymmetry and increase investor confidence. These credible positive signals, especially those supported by high and sustained actual earnings growth, will enhance the company's stock valuation as investors anticipate improved future cash flows.

2.5 Hypothesis

2.5.1 Impact of Non-Performing Financing on Profit Growth

Non-Performing Financing, or NPF, is a situation where the loan repayment agreement is at risk of failure, with a likelihood of potential losses. The existence of Non-Performing Financing in

high amounts will cause difficulties and reduce the health of the bank concerned (Maulana & Febriyanti, 2021). Non-performing financing has a relationship that is opposite to profit growth. If Non-Performing Financing has increased, profit growth will decrease and vice versa. This is in accordance with the theory that the smaller the NPF, the less income is obtained, which affects the level of profit growth in Islamic banks. According to reports, when non-performing financing (NPF) decreased, profit growth increased. In general, the problems that occur in NPF are caused by strategic errors in the distribution of financing activities, resulting in a high level of financing risk that affects the profit of Islamic banks, which in turn impacts the acquisition of profit growth rate. The results of this study are supported by Marina (2018) research, which explains that Non-Performing Financing (NPF) has a negative and significant effect on profit growth.

H₁: Non-Performing Financing has a negative and significant effect on profit growth

2.5.2 Impact of Capital Adequacy on Profit Growth

Capital adequacy is a banking regulation that sets a framework for how banks and depository institutions should handle their capital. Capital adequacy refers to a bank's ability to maintain sufficient capital to cover the risk of losses that may arise from investing funds in assets that carry risks, as well as for financing fixed assets and investments. Adequate capital can increase public confidence because it indicates that the bank can absorb the possible risk of losses that it may incur due to its operational activities. That way, capital adequacy will have an impact on increasing profits or profitability obtained by banks through interest on credit loans. CAR is an indicator often used to measure a bank's capital adequacy level (Setiawati, 2017).

CAR is an aspect of bank capital adequacy that shows the ability of bank management to supervise and Control Risks that occur, which can affect the amount of bank capital. Banks that have adequate capital can conduct their operations efficiently and will provide benefits to the bank. The higher the capital adequacy ratio, the stronger the bank will be in bearing the risk of each credit and financing its operations, thereby contributing significantly to profit growth. A CAR above 8% indicates the bank's business is increasingly stable, due to the large public trust. It can be assumed that capital adequacy (CAR) has a positive effect on profit growth.

H₂: Capital adequacy significantly positively influences profit growth

3. Research Methods

In this study, the researchers employed descriptive quantitative research methods, utilizing secondary data from the annual reports of each Islamic Commercial Bank, downloaded from the internet, to obtain data on NPF, CAR, and profit growth. The research approach employed is explanatory. Explanatory research (explanatory research) is research that aims to analyze the relationships between one variable and another variable or how a variable affects other variables (Sari et al., 2022).

The population in this study consists of Sharia commercial banks in Indonesia registered with the OJK from 2020 to 2024. The sample is a part of the population's number and characteristics. In this study, sampling was conducted using Purposive Sampling (Subhaktiyasa, 2024). The following sample criteria have been determined in the study: The number of Islamic commercial banks registered in the FSA during the period of this study is 14. Then, the sample was determined using the purposive sampling technique, resulting in 12 Islamic commercial banks that met the criteria as the sample for a 5-year research period. Consequently, the study utilized 60 observational data points. The research instruments employed in this study are designed to define a variable by providing a clear and precise definition or specifying the operational steps necessary to measure it.

Table 2. Definition of Variable

Variable	Operational Definition	Measurement	Scale
Non-Performing	Non-Performing Financing (NPF) is a risk indicator that measures the percentage of total		Ratio

Financing (NPF)	financing provided by Islamic banks that are in the category of problematic or defaulted by customers (Siyamto, 2025).	$\text{NPF} = \text{Amount of Troubled Financing} / \text{Total Financing}$	
Capital Adequacy Ratio (CAR)	Capital Adequacy Ratio (CAR) is a capital adequacy ratio that shows the bank's ability to bear the risk of losses that may arise from the bank's operating activities and is calculated based on the comparison between the bank's total capital and Risk-Weighted Assets (Siregar et al., 2023).	$\text{CAR} = \text{Capital} / \text{ATMR}$	Ratio
Profit Growth	Profit growth is an increase in the percentage of net profit or operating profit of the company in a period compared to the previous period, reflecting an increase in operational success and management effectiveness (Martini & Siddi, 2021).	$\text{Profit Growth} = \frac{Y_t - Y_{t-1}}{Y_{t-1}} \times 100\%$	Ratio

In this study, we employed the method of panel data regression analysis using the EViews software. Regression analysis of panel data combines cross-sectional data and time series data. In this study, the estimation approach model is the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM) (Alamsyah et al., 2022). These three models are then tested to determine which one is best to use by performing the Chow Test, Hausman Test, and Lagrange Multiplier Test (Aprilianti et al., 2022). Additionally, the test of classical assumptions was performed, including the normality Test, multicollinearity Test, heteroscedasticity Test, and autocorrelation Test (El Kavi & Nuryatno Amin, 2024). Hypothesis tests include the T-test, F-test, and R-test (Amelia et al., 2020).

4. Results and Discussion

4.1 Results

The research was conducted using panel data regression with estimation approaches that are the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM). These three models are then tested to determine which one is the best to use by performing the Chow Test, Hausman Test, and Lagrange Multiplier Test. Based on the results in Table 3, the probability value of the cross-section is 0.3028, which is greater than 0.05; therefore, H_0 is rejected. Thus, the model chosen is the Common Effect Model (CEM). Based on the results, the cross-section probability value is 0.0525, which is greater than 0.05; therefore, H_0 is rejected. Thus, the model chosen is the Random Effect Model (REM). Based on the results, the probability value of the Breusch-Pagan test is 0.0920, which is greater than 0.05; therefore, H_0 is rejected. Thus, the model chosen is the Common Effect Model (CEM). The results of the analysis using CEM are presented in Table 4.

Table 3. Best Model Selection

Effects Test	Test Chow	Hausman Test	Lagrange Multiplier Test
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Cros s-section Chi-square Prob.	0,3028	0,0525	0,0920
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Source: Data processed (2025)

Table 4. Common Effect Model

Variabel	Coefficient	Sd. Error	t-Statistic	Prob
C	-0,000624	0,466131	-4291976	0,0002
NPF	0,767183	0,256565	2,990203	0,0056
CAR	0,006526	0,007259	0,899055	0,3760

Source: Data processed (2025)

Based on the results of the t-test, the NPF variable obtained a value of $p. 0.0056 < 0.05$ and the coefficient value of 0.767183. It can then be demonstrated that the problematic financing has a positive and significant impact on profit growth. Therefore, H1 is rejected. The results of this study showed that the higher the NPF, the lower the profit growth; conversely, the lower the NPF, the higher the profit growth. Variable car obtains the value of prob. $0.3760 > 0.05$ and the coefficient value of 0.006526. It can then be demonstrated that capital adequacy does not impact profit growth. Therefore, H2 is rejected. The results of this study indicate that CAR does not significantly affect the ability of banks to generate profits from their total assets.

4.2 Discussion

4.2.1 Impact of Non-Performing Financing on Profit Growth

The results of the first test showed that Non-Performing Financing has a positive and significant effect on profit growth. Then H1 is rejected. The results of this study showed that the higher the NPF, the lower the profit growth; conversely, the lower the NPF, the higher the profit growth. These results also indicate an anomaly or phenomenon that warrants further investigation. A possible explanation for this result is that Islamic commercial banks with high NPFS also have significantly higher financing margins or substantial non-operating income, allowing their net profits to continue growing despite having to reserve losses. In addition, there may be a time delay between the recognition of the NPF and its impact on profits, or the bank may be aggressive in financing expansion, which simultaneously promotes an increase in the overall gross profit volume.

This study is not in accordance with the theory proposed by Michael Spence in signaling theory, where high NPF levels can be considered an indication that banks do not have a strong ability to manage credit risk. This could be a negative signal for investors, customers, and other external parties, potentially affecting investment decisions or business relationships and directly impacting profit growth. In 2020, during the beginning of the COVID-19 pandemic, there was an increase in NPF (Tanjung et al., 2024). This indicates that COVID-19 will also impact Non-Performing Financing, as many individuals have experienced reduced or lost income. In 2021, specifically during the period of the new normal until 2024, it showed a recovery, with the NPF value decreasing after the COVID-19 pandemic. With the return to normal revenue, the possibility of difficulty paying credit/financing will be reduced, which can, in turn, reduce NPL/NPF and increase profit growth (Septyanto & Susilowati, 2022). The results of this study are not in line with research conducted by Marina (2018), who explained that Non-Performing Financing (NPF) has a negative and significant effect on the growth of the Laba. But the results of this study, in line with research conducted by Jati (2018), suggest that Non-Performing Financing (NPF) has a positive and significant impact on profit growth.

4.2.2 Impact of Capital Adequacy on Profit Growth

The results of the second test showed that capital adequacy did not affect profit growth. H2 is rejected. The results of this study indicate that the CAR does not significantly affect the ability of banks to generate profits from their total assets. This can occur because the high CAR that

exceeds the regulatory minimum is often interpreted as an excess of idle capital and is not aggressively optimized for the expansion of productive assets, particularly financing, which is the primary source of Islamic bank profits. In practice, the focus of business management may be more directed towards operational efficiency, as reflected by ratios such as BOPO or asset quality (NPF), where improvements in both factors have a more immediate and direct impact on increasing profits, compared to capital gains that only serve as a buffer for long-term risks. In addition, changes in bank profits are more sensitive to external factors and niche market strategies specific to Sharia products, so the amount of Capital owned (CAR) becomes a secondary variable in determining the growth trend in bank profitability from year to year.

This study is not in accordance with the theory proposed by Michael Spence in signaling theory, which suggests that a high CAR indicates that banks with high capital adequacy can provide positive signals to investors. With adequate capital can open opportunities for greater profit growth. The capital adequacy of Islamic commercial banks before and during the COVID-19 pandemic in 2019-2020 did not experience significant differences. Until 2021, the enactment of the New Normal until 2024, the capital adequacy of Shariah Commercial Banks remains very good and is increasing. This is due to the government's aggressive efforts to maintain capital stability and national banking liquidity, including through regulation of the Minister of Finance (PMK) No. 70/PMK.05/2020, by placing funds worth Rp. 30 trillion in state-owned banks where the funds are placed in the form of deposits so that additional funds maintain the stability of the banking sector capital. This policy is what really helps the banking sector in maintaining its capital performance during the Covid-19 pandemic (Agung Anggoro & Septiani, 2021). The growth of the CAR is also accompanied by an increase in (Jati, 2018). This study is not in line with research conducted by Jati (2018), which suggests that the Capital Adequacy Ratio (CAR) is influential and significant in relation to profit growth. However, the research aligns with studies conducted by Dewi et al. (2024), who found that the Capital Adequacy Ratio (CAR) has no significant effect on profit growth.

5. Conclusion

This study aims to determine the effect of Performing Financing and capital adequacy on profit growth in Islamic commercial banks. This study sampled 12 Islamic commercial banks, examining their annual reports for five consecutive years from 2020 to 2024. The results of this study concluded that partially Non-Performing Financing has a positive and significant effect on profit growth, while capital adequacy does not affect profit growth. The implications of the findings of this study suggest that the primary focus of Islamic Commercial Bank management should be on the management of non-performing financing (NPF), as results that show a positive and partially significant effect indicate that successful collection efforts or a decrease in the NPF rate effectively and quickly translate into better profit growth.

However, the finding that capital adequacy (CAR) has no partial effect challenges the traditional view that high capital directly drives profits, implying that for Islamic commercial banks in the 2020-2024 period, having capital above the minimum threshold may not be an efficient profit driver, but rather merely a risk buffer. Nevertheless, the simultaneous influence confirms that banks must maintain a balance between the two, keeping NPF under control while maintaining sufficient CAR to support long-term stability and growth. Therefore, the policy should be directed at improving asset quality (by suppressing NPF) and optimizing the use of capital (by not holding excessive capital) to achieve maximum profitability.

The main limitation of this study lies in its scope of time and variables, which only involved 12 Islamic commercial banks with a relatively short panel data analysis period, specifically 2020-2024, and focused solely on problem financing (NPF) and capital adequacy (CAR). Therefore, for future studies, it is advisable to expand the scope of the analysis period to capture a more complete business cycle and test the stability of the findings, as well as add other independent variables that are relevant in influencing Islamic banking profit growth, such as operational efficiency (BOPO), liquidity (FDR), or macroeconomic variables (such as inflation or GDP), so as to provide a more comprehensive and accurate predictive model regarding profitability.

Author Contributions

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