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# THE INFLUENCE OF DEBT FINANCING, EQUITY FINANCING, AND NON PERFORMING FINANCING ON THE FINANCIAL PERFORMANCE OF SHARIA COMMERCIAL BANKS IN INDONESIA FOR THE 2017-2022 PERIOD

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**Abstract.** In the 2017-2022 period, the financial performance of Sharia Commercial Banks in Indonesia is influenced by debt financing, equity financing and non-performing financing (NPF). Increasing use of debt and equity also increases NPF. This is a challenge in bank credit risk management. This quantitative research uses multiple regression analysis methods and panel data, using Eviews 10 software. The aim of this research is to discover and analyze how the variables of debt financing, equity financing and bad credit have an impact on the financial performance of Sharia Commercial Banks in Indonesia from 2017 to 2022. The research results show that debt financing has a positive influence on ROE. Meanwhile, equity financing and non-performing financing (NPF) have a negative influence on the financial performance (ROE) of Islamic Commercial Banks in Indonesia at the same time. This shows that with good management of credit financing, profit-sharing financing, and bad credit in sharia banks, including Murabahah schemes for buying and selling transactions, Mudharabah and Musyarakah for profit sharing models, as well as special mechanisms to handle payment difficulties by customers according to the principles sharia, able to maintain adequate capital so that sharia bank equity can increase.

**Keywords:** debt financing; equity financing; non performing financing; return on equity; sharia banking

## I. INTRODUCTION

The development of Islamic economics is often linked to the progress of sharia financial institutions. Islamic banks, basically based on the principles of the Koran and Hadith, have a crucial role in promoting a financial system that is in accordance with Islamic values. By providing products and services based on the principles of justice, transparency and sustainability, Islamic banks not only aim to create material and spiritual prosperity for the people, but also to build an inclusive and sustainable economy. Through profit sharing mechanisms and financing based on real assets, Islamic banks support the development of micro, small and medium enterprises, sustainable investment in infrastructure and other productive sectors. Thus, Islamic banks play an important role in strengthening the foundations of the global Islamic economy by providing a sustainable and ethical alternative in the world of international finance. Sharia banks function as intermediary bodies that uphold the need to connect financially strong parties with parties that need restructuring, in line with a principle in the Koran and Hadith. As a liaison between entities that wish to invest or merge with entities that need funds for business expansion or consumer needs, Islamic banks provide various financial products and services based on the principles of justice and blessing. In practice, Islamic banks offer financing through schemes such as murabahah, mudharabah, musyarakah, and ijarah, which allow them to manage risks and distribute profits fairly between both parties. Thus, an Islamic bank not only acts as a catalyst in promoting financial inclusion and building a sustainable and ethical economy in a global context.

Financial performance is the main focus for Islamic banks, because this influences the level of public trust, the stability of financial institutions, and their contribution to overall economic growth. Islamic banks are obliged to carry out these actions as a business of various financial institutions that operate based on security principles. achieve balanced profitability by maintaining fairness and blessings in every transaction. The assessment of the financial performance of Islamic banks includes various indicators such as profitability ratios, operational efficiency, asset quality and liquidity, which are benchmarks in assessing their success in carrying out their intermediation function by complying with sharia principles. Apart from that, good financial performance also has the potential to increase the competitiveness of Islamic banks in the global market, expand access to financial resources, and improve services to customers and their contribution to sustainable economic development.

In this context, understanding profitability theory and the influencing factors is very important in evaluating the financial performance of sharia banks. Debt financing, profit sharing, and NPF. Debt financingis a type of financing that provides funds to debtors with the condition that the principal be returned along with additional interest or fixed profits. In principle, debt financing involves capital loans which according to the agreement are completed within a specified

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time frame. Regarding Islamic banks, although the terms are unique when compared to general banks which use the term credit, the fundamental standards and targets for supporting obligations remain the same as before. namely to provide funds to individuals or entities who need them for various purposes such as business capital, investment, or consumer needs. The use of debt financing provides benefits to debtors by providing quick access to the funds needed without having to take risks in the business. Non Performing Financing (NPF)is one of the important criteria used by the sharia banking sector which measures the proportion of unrecoverable or problematic financing in a bank's financing portfolio. This ratio provides an overview of the quality of a sharia bank's productive assets by showing how well the bank manages its credit risk. Financing is categorized as non-performing if the debtor experiences difficulty in completing its commitment to pay the portion or main funding on time, or if there are serious indications that the refund of the funds provided cannot be fully realized.

A high NPF level can be an indication of significant potential risk for Islamic banks, affecting profitability, financial stability and public trust in the institution. Therefore, the success of the credit risk board is very important for Islamic banks in monitoring and reducing NPF, with the aim of maintaining financial health and providing trust to customers and related stakeholders in the long term. (Zaibah, 2015). If the NPF exceeds 5%, Bank Indonesia (BI) warns that this could threaten banking health. Non Performing Financing(NPF) is used in sharia banking, referring to bad credit in terms of refunds by the party who provided the financing. The term "financing" is used because Islamic banking is based on sharia which prohibits interest income and usury, so their approaches differ in terminology but still have similar objectives to assess the quality of the bank's productive assets and manage credit risk effectively. (Firmansari and Suprayogi, 2015). Therefore, the Financial Services Authority is the body that directs and manages monetary administration considering that banking for Indonesia will make calls to banks that have high levels of non-performing financing in order to anticipate that the non-performing financing ratio does not reach 5% (Sovisiun, 2014) . This is not in accordance with the aim of establishing a sharia bank to fulfill falaah. (prizes in this world and the hereafter) and also realizing a superior life according to Islamic sharia standards (Suryani, 2011) and the essence of the layout. Islamic banks to increase supporting value work that refers to Islamic legal standards for government assistance to individuals (Hidayat, 2012). The high interest in debt financing in sharia banking financing is caused by a number of obstacles, both interior and exterior. One of the external difficulties in value financing is the greater degree of danger associated with possible losses, for the reason that the sharing of profits as well as the risk of misfortune must be shared, unless the gamble is not made by the parties. given support. Therefore, high confidence is needed in providing support to individuals who need it (Susilawati, 2016). However, the value-supporting methodology encourages borrowers to be more energetic in further developing their business operations because they share responsibilities and are regulated by the bank, so that business tasks can be controlled. Meanwhile, debt financing only relies on borrower funds without strict supervision from the bank (Susilawati, 2016).

The use of ROE as a sign of Islamic bank productivity is very important because it reflects the ability of executives to utilize existing funding to create net profits. ROE estimates the level of profit received from capital owners or organizational investors (Hasibuan, 2007). As a significant support point in the economy, inspection of bank execution by supervisors is very important. One of the indicators used is bank benefits, which describes how productive the bank is in carrying out its duties. A bank's performance is correlated with its profitability. ROE and ROA are indicators of the profitability of Islamic banks in Indonesia. Previous examination, for example, directed by Siti Zahara (2014), shows that value support and liability funding firmly influence the monetary presentation of Islamic banks. In addition, other studies related to banking benefits, as stated by Zaibah (2015), show that bond funding, value support, and problem funding have an impact on ROA and ROE as a marker of productivity. Based on this background, the author is interested in developing research with the title"The Influence of Debt Financing, Equity Financing and Non-Performing Financing on the Financial Performance of Sharia Commercial Banks for the 2017-2022 Period"

*Return on Equity (ROE)*

Ardimas & Wardoyo (2014) state Profit on Equity in utilizing cash flow value to produce net benefits. ROE is a basic estimate used by financial proponents and scientists to evaluate the financial performance of a company. The capacity of an organization to generate large revenues from every dollar it owns is demonstrated by a high level of ROE, which is often considered an indication of management efficiency in the use of company resources. Careful ROE analysis can provide insight into how well a company is managing its shareholders' investments and its ability to deliver profitable returns. Therefore, ROE is a significant benchmark in evaluating the monetary presentation of a business substance. Meanwhile, according to (Sugiono and Untung, 2016) Profit on Equity is a very important financial aspect for assessing the financial performance of an organization. ROE can be calculated by collecting pure profits with all shareholder equity, as stated by Sugiono and Untung (2016). ROE is defined as a description of the efficiency value of a company element in order to obtain optimal profits. The greater the return on equity, the better the organization's effectiveness in generating profits from contributed capital. Nonetheless, ROE must also be logically dissected against the company and other competitors to gain a deeper understanding of the overall performance of the organization. In addition, to increase ROE, companies can adopt strategies such as increasing operational efficiency, managing capital structure well, or increasing profitability through product innovation or market development. Thus, ROE is not only an indicator of financial performance, but also a strategic basis for increasing company value in the long term.

*Debt Financing*

Debt financingis a funding method in which funds are obtained through loans with the promise of repayment with interest. In contrast to this concept, in the context of Islamic economics, buying and selling (al-ba'i) refers to the transaction

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of exchanging goods or services between two people or more in accordance with provisions in accordance with Islamic law, prioritizing justice and avoiding usury and excessive uncertainty (gharar ). Sharia buying and selling transactions must be carried out fairly, transparently and in harmony with an assessment based on Islamic economic concepts, as part of efforts to ensure compliance with economic principles based on sharia.

*Equity Financing*

Equity financingis a cooperation agreement in which capital is obtained by selling company shares to investors. In this contract, investors provide funds in exchange for partial ownership of the company, which means they are entitled to a portion of the company's profits and potentially suffer losses if the company's performance declines. This form of financing does not involve an obligation to return funds as in debt financing, but rather provides participation rights in determining the organization's choice according to the claimed bid amount. Equity financing is often used by companies that want to expand operations without increasing debt burdens, and it also encourages active investor involvement in company management, which can bring benefits in the form of additional networks, expertise and resources. In addition, equity financing can increase a company's credibility in the eyes of the public and financial markets, because it shows that investors have confidence in the company's future growth prospects. (Raharjo, 2007). There are two types of support with a benefit sharing framework based on Mudarabah guidelines and Musyarakah standards.

*Non Performing Financing*

Non Performing Financing(NPF) is a financial facility that experiences congestion where the debtor is unable to fulfill payment obligations. NPF is an indicator of the financial health of financial institutions, because a high NPF ratio indicates large credit risk. The causes of NPF can come from poor economic conditions, weak management, or external factors. The impact of a high NPF is a decrease in liquidity and profitability of financial institutions. Therefore, effective risk management strategies are very important to control NPF, such as strict credit assessment and restructuring of problematic financing. In accordance with Bank Indonesia Circular Letter (SE BI) No. 9/24/Dpbs dated 30 October 2007 concerning the Bank Health Assessment Framework Based on Sharia Principles,

## II. RESEARCH METHOD

This research methodology adopts a quantitative approach which aims to extract information from the selected population or sample. Through this approach, data is collected using structured research instruments, such as questionnaires or surveys, to obtain accurate and objective information. This data collection allows researchers to analyze the results using statistical techniques or other quantitative methods, so that previously formulated hypotheses can be tested empirically. This research focuses on three independent variables believed to influence one particular dependent variable. In this context, researchers examine the performance and factors that impact Islamic banks in Indonesia. With the help of data collected from several sharia banks at Bank Indonesia, this research covers the analysis period from 2017 to 2022. This study can improve our understanding of Islamic banking practices in Indonesia. Can help develop more efficient sharia banking policies and strategies. This will improve the performance and competitiveness of Islamic banks in the future. To take research samples, a purposive sampling method was used, and specific selection criteria were determined as follows:

1. Sharia Commercial Banks in Indonesia, registered with BI.
2. BUS published financial reports.
3. Published financial reports cover the 2017-2022 period.

The sample in this study was 7 Sharia Banks totaling 42 data points for 6 years. The important aspects of this research are:1. BMI (Bank Muamalat Indonesia), 2. BJBS (Bank Jabar Banten Syariah), 3. BPS (Panin Sharia Bank), 4. BSB (Bukopin Sharia Bank), 5. BCAS (Bank Central Asia Sharia), 6. BTPNS (BTPN Syariah, 7. BSI (Indonesian Sharia Bank)

Secondary data collected from various sharia banks registered with Bank Indonesia was used in this research. This secondary data includes information about financial performance, asset growth, financial ratios and other relevant indicators during the 2017-2022 period. By utilizing this secondary data, researchers can analyze existing trends and patterns in Islamic bank operations, as well as identify several factors that control their performance in the economic context and applicable regulations. This approach allows research to gain deeper insight into the dynamics of the Islamic banking industry in Indonesia, with the aim of making a meaningful contribution to the development of strategies and policies in the future.

## III. RESULTS AND DISCUSSION

*The Effect of Debt Financing on the Financial Performance of Sharia Commercial Banks*

The Debt Financing indicator gets the t valuecount 3.274874means tcountsmaller than ttable(The calculated t value for Debt Financing is 3.274874, which exceeds the t table value (2.02439), having a level of 0.0025 lower than the threshold of 0.05. The research results indicate that Liability Funding has an impact on ROE. The support obligation in this arrangement refers to funding in return for Islamic banking services. Islamic bank production increases with the level of funding. This occurs because all customers must pay their obligations to the bank, including the profits agreed at the beginning of the agreement. This finding can be predicted by research by Febrina Rizka Zaibah (2015) which states that Obligation Funding basically influences Return on Equity (ROE) in Sharia Business Banks in Indonesia. In this way, the growth of Islamic banking benefits will increase, along with an increase in resources which will also clearly affect value.

*The Influence of Equity Financing on the Financial Performance of Sharia Commercial Banks*

The t test value obtained is -3.778544, meaning tcountexceeds ttable ($-3.778544 > 2.02439$) and the significance value ($0.0145 < 0.05$). The results show that it has an impact on ROE. This has a negative impact because it is

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difficult for banks to accurately assess the characteristics of prospective customers, which can lead to misjudgments in providing financing. In addition, there is a possibility that customers report inappropriate results or are not honest about the results obtained, which could cause losses for the bank after support is completed. The benefits of Debt Financing are very dependent on the capital that has been invested in supporting resources, so the bank's benefits cannot be guaranteed. This result is the same as research by Febrina Rizka Zaibah (2015) that increasing equity has an impact on ROE. This shows that the use of Islamic banks is also influenced by financial performance, but in this condition productivity will increase assuming the use of financial performance is reduced. Then research by Ahmed (2015), Ogilo (2016), and Kurniawansyah (2016) found that Equity Financing had an effect on financial performance. They argue that equity can be increased when banks increase the utilization of financial performance.

*The Influence of Non-Performing Financing on the Financial Performance of Sharia Commercial Banks*

The t value obtained -2.538920 exceeds the threshold (-2.538920 > 2.02439) and has a significance level of 0.016 (<0.05). Based on these findings, NPF has an impact on ROE. The hypothesis put forward is that the relationship between NPF and Return On Equity (ROE) will change, with increasing NPF and increasing ROE which Islamic banks may be able to use to protect their assets. The results of this study are the same as previous research by Nike Nurvarida (2017) which concludedNPF has an impact on the profits of sharia business banks. The negative impact shown by the NPF shows that an increase in the level of non-performing financing can cause a decrease in the proportion of Return on Equity (ROE), because the assistance provided cannot be returned on time..

*The Influence of Debt Financing, Equity Financing and Non-Performing Financing on the Financial Performance of Sharia Commercial Banks*

According to the research results, Fcount > Ftable was 7.822 > 2.85, through the sig level. 0.000 < 0.05. As a result, debt financing, equity financing, and distressed financing can all impact financial performance at the same time. These results can be shown that if Islamic banks can manage risks, identify problematic assets, and manage capital liquidity, then their value can increase. This is because sharia banks have the ability to serve the government in accordance with principles that have not been fully implemented by Bank Indonesia.

## IV. CONCLUSIONS

Based on research findings regarding the influence of DF, EF, and NPF on banking operational performance, it can be concluded that debt funding has a tcount of 3.274874, greater than the ttable (3.274874 > 2.02439) which is marked. This suggests a positive influence of debt funding on ROE. The research results showed that t was -3.778544 which was greater than the threshold (-3.778544 > 2.02439) and had a sig value. (0.0145 < 0.05). This study shows that there is a negative influence of equity financing on financial performance (ROE). From the research results, a t value of -2.539 was obtained, which exceeds the critical threshold (-2.02439), with a significance level of negative influence on Financial Performance (ROE). These results strengthen the hypothesis that this variable has an impact on ROE, so that changes in this variable have the potential to affect the company's financial performance.0.016<0.05

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