

**Impact of Debt Financing and Equity Financing
on Profit Expense Ratio of Islamic Banks in Indonesia**



Mini-thesis by:

NENDEN SITI MARIAM

01111001122

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**IMPACT OF DEBT FINANCING AND EQUITY FINANCING
ON PROFIT EXPENSE RATIO OF ISLAMIC BANKS
IN INDONESIA**

Disusun oleh :

Nama : Nenden Siti Mariam
NIM : 01111001122
Fakultas : Ekonomi
Jurusan : Manajemen
Bidang Kajian/Konsentrasi : Manajemen Keuangan

Disetujui untuk digunakan dalam ujian komprehensif.


Tanggal Persetujuan

Dosen Pembimbing

Tanggal

Ketua

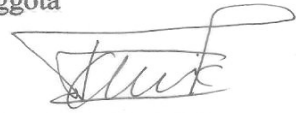
Kamis, 17 November 2016


H. Isnurhadi, M.B.A., Ph.D
NIP. 196211121989111001

Tanggal

Anggota

Rabu, 26 Oktober 2016


H. Taufik, S.E., M.B.A.
NIP. 196709031999031001

LEMBAR PERSETUJUAN SKRIPSI

**The Impact of Debt Financing and Equity Financing on Profit Expense Ratio
of Islamic Banks in Indonesia**

Disusun oleh:

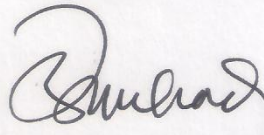
Nama mahasiswa : Nenden Siti Mariam
NIM : 01111001122
Fakultas : Ekonomi
Jurusan : Manajemen
Bidang Kajian/Konsentrasi : Manajemen Keuangan

Telah diuji dalam ujian komprehensif pada tanggal 7 Desember 2016 dan telah memenuhi syarat untuk diterima.

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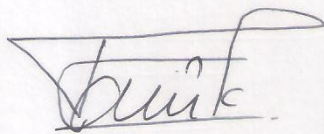
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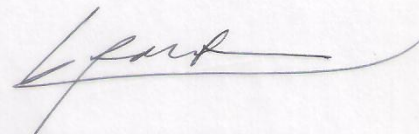
H. Isnurhadi, M.B.A., Ph.D.
NIP. 196211121989111001

Anggota



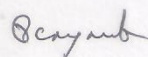
H. Taufik, S.E., M.B.A.
NIP. 196709031999031001

Anggota



Drs. H. Umar Hamdan AJ, M.B.A.
NIP. 195007091985031001

Mengetahui,
Ketua Jurusan Manajemen



Dr. Zakaria Wahab, M.B.A.
NIP. 195707141984031005

SURAT PERNYATAAN INTEGRITAS KARYA ILMIAH

Yang bertanda tangan di bawah ini:

Nama mahasiswa : Nenden Siti Mariam
NIM : 01111001122
Bidang Kajian : Manajemen Keuangan
Fakultas : Ekonomi

Menyatakan dengan sesungguhnya bahwa skripsi yang berjudul:
The Impact of Debt Financing and Equity Financing on Profit Expense Ratio of
Islamic Banks in Indonesia.

Pembimbing :
Ketua : H. Isnurhadi, M.B.A., Ph. D.
Anggota : H. Taufik, S.E., M.B.A.
Tanggal ujian : 7 Desember 2016

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Inderalaya, 7 Desember 2016
Pernyataan,



Nenden Siti Mariam
NIM. 01111001122

FOREWORD

Praise be to Allah SWT for His mercy and grace so that the author can complete this research entitled The Impact of Debt Financing and Equity Financing on Profit Expense Ratio of Islamic Banks in Indonesia. This thesis is written as completion to the bachelor degree of economics at Sriwijaya University South Sumatera, Indonesia.

This thesis discusses the extent to which Islamic banks in Indonesia can increase their efficiency in gaining profits through the use of funds and the financing system that mostly implemented, also with the expense that have to be borne by Islamic banks. During the research and preparation of this thesis, the author does not escape from the constraints. These obstacles can be overcome by the help, guidance and support from various parties. The author would like to express gratitude to:

1. Thesis supervisors who had sacrificed their time, energy, thoughts to guide and provide advice in completing this thesis
2. Head of Management Department
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4. Thesis examiners who provided comments and suggestions
5. Beloved parents

Indralaya, December 14th 2016

Author

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During the observation and preparation of this research, the author certainly does not escape from the constraints. All obstacles can be overcome by the help, guidance, and support from various parties. So on this occasion, the author would like to thank:

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Inderalaya, December 14th 2016

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MOTTO AND DEDICATION

وَمَنْ جَاهَدَ فَإِنَّمَا يُجَاهِدُ لِنَفْسِهِ إِنَّ اللَّهَ لَغَنِيٌّ عَنِ الْعَالَمِينَ



And whoever strives only strives for [the benefit of] himself. Indeed, Allah is free from need of the worlds - Surah Al-'Ankabut [29:6]

أَمَّنْ يُجِيبُ الْمُضْطَرَّ إِذَا دَعَاهُ وَيَكْشِفُ السُّوءَ
وَيَجْعَلُكُمْ خُلَفَاءَ الْأَرْضِ أَأَلَا لَهُ مَعَ اللَّهِ قَلِيلًا مَّا

تَذَكَّرُونَ

Is He [not best] who responds to the desperate one when he calls upon Him and removes evil and makes you inheritors of the earth? Is there a deity with Allah ? Little do you remember - Surah An-Naml [27:62]

Within the weakness, i found my strenght.

This thesis is dedicated for:

My beloved parents, sisters and brother.

My beloved friends.

To alma mater.

SURAT PERNYATAAN

Kami dosen pembimbing skripsi menyatakan bahwa abstraksi dari mahasiswa:

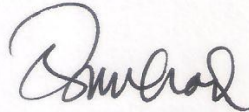
Nama : Nenden Siti Mariam
NIM : 01111001122
Jurusan : Manajemen Keuangan
Judul Skripsi : The Impact of Debt Financing and Equity Financing on Profit Expense Ratio of Islamic Banks in Indonesia.

Telah kami periksa cara penulisan *grammar*, maupun *tenses*-nya dan kami setuju untuk ditempatkan pada lembar abstrak.

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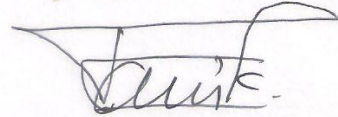
Pembimbing skripsi:

Ketua



H. Isnurhadi, M.B.A., Ph. D.
NIP. 196211121989111001

Anggota



H. Taufik, S.E., M.B.A.
NIP. 1967090319990301001

ABSTRAK

The Impact of Debt Financing and Equity Financing on Profit Expense Ratio of Islamic Banks In Indonesia

Oleh:

Nenden Siti Mariam

Tujuan penelitian ini adalah untuk mengetahui apakah sistem pembiayaan Debt Financing dan Equity Financing berpengaruh terhadap Profit Expense Ratio, baik secara parsial maupun bersamaan. Penelitian ini merupakan penelitian kausal, juga disebut sebagai penelitian eksplanatori yang adalah investigasi (penelitian) hubungan sebab-akibat. Objek di dalam penelitian ini adalah PT. Bank Muamalat Indonesia (BMI) dan PT. Bank Syariah Mandiri (BSM). Data yang digunakan dalam penelitian ini adalah data sekunder dari laporan keuangan yang diterbitkan oleh BMI dan BSM. Teknik analisis data yang digunakan adalah regresi linear. Hasil analisis data dalam penelitian ini yaitu terdapat hubungan langsung atau positif antara Debt Financing dan Equity Financing terhadap Profit Expense Ratio. Sedangkan pengaruh dari Debt Financing dan Equity Financing sebagai variabel independen (X) secara simultan mempengaruhi Profit Expense Ratio sebagai variabel dependen (Y) dari bank syariah di Indonesia. Nilai yang diperoleh dari koefisien determinasi (R^2) adalah 0,516 atau 51,6%. Ini berarti bahwa variasi variabel-variabel independen, yaitu Debt Financing dan Equity Financing, berpengaruh terhadap Profit Expense Ratio bank syariah. Sesuai dengan hasil analisis penelitian ini, dapat dilihat bahwa Equity Financing adalah variabel dominan dalam mempengaruhi Profit Expense Ratio bank syariah bila dibandingkan dengan Debt Financing. Peneliti menyarankan bagi pihak manajemen bank syariah untuk memprioritaskan sistem pembiayaan Equity Financing, terutama Musyarakah, karena sistem pembiayaan tersebut adalah sistem pembiayaan yang paling sesuai dengan hukum Islam.

Kata kunci: Debt Financing, Equity Financing, Profit Expense Ratio.

ABSTRACT

The Impact of Debt Financing and Equity Financing on Profit Expense Ratio
of Islamic Banks In Indonesia

By:

Nenden Siti Mariam

The purpose of this study is to determine whether Equity Financing and Debt Financing partially and simultaneously have an impact on Profit Expense Ratio, also how the partial effect of each financing systems affect Profit Expense Ratio. This research is causal research, also called explanatory research is the investigation of (research into) cause-and-effect relationships. The number of taken samples is two, such as PT. Bank Muamalat Indonesia (BMI) and PT. Bank Syariah Mandiri (BSM). The data used in this research are secondary data from published financial statements of BMI and BSM. The data analysis technique used is linear regression. The results of data analysis in this research is partially contained direct or positive relationship between Debt Financing and Equity Financing on Profit Expense Ratio. While the effects of Debt Financing and Equity Financing as the independent variables (X) simultaneously affect Profit Expense Ratio as the dependent variable (Y) on Islamic banks, it means that Debt Financing and Equity Financing simultaneously have significant impacts on Profit Expense Ratio of Islamic banks. The obtained value of coefficient of determination (R²) is 0.516 or 51.6%. It means that the variation of these independent variables, namely Debt Financing and Debt Financing, contribute effects on Profit Expense Ratio of Islamic Banks. In accordance with the analysis result of this research, it can be seen that Equity Financing is dominant in affecting Profit Expense Ratio of Islamic Banks compared to Debt Financing. The researcher suggests management of Islamic banks to prioritize Equity Financing system, especially Musharaka, because the said financing system is the most appropriate with Islamic law to apply to muslims.

Keywords : Debt Financing, Equity Financing, Profit Expense Ratio

DAFTAR RIWAYAT HIDUP

Nama Mahasiswa : Nenden Siti Mariam
Jenis Kelamin : Perempuan
Tempat Tanggal Lahir : Palembang, 16 September 1993
Agama : Islam
Status : Belum Menikah
Alamat Rumah (Orangtua) : Jl. Urip Sumoharjo Lr. Manunggal RT. 23 RW. 09 NO. 2321
Sekojo - Palembang
Alamat E-mail : nendensitimariam@yahoo.com

Pendidikan Formal :

Sekolah Dasar : SD NEGERI 66 PALEMBANG
SMP : SMP NEGERI 29 PALEMBANG
SMA : SMA NEGERI 5 PALEMBANG

Pengalaman Organisasi :

1. Anggota Divisi Pelatihan dan Pengembangan IKAMMA FE UNSRI 2012/2013
2. Kepala Departemen Sosial dan Public Relationship IKAMMA FE UNSRI 2013/2014
3. Sekertaris IKAMMA FE UNSRI 2014/2015

Seminar dan Pelatihan :

1. Peserta Pelatihan Manajemen Organisasi IKAMMA 2011
2. Peserta Seminar Hukum Untuk Pembangunan Dan Peluncuran Buku Teori Hukum Integratif FH UNSRI 2012
3. Panitia Pelatihan Manajemen Organisasi Pelajar Sumatera Selatan 2012
4. Panitia Pelatihan Manajemen Organisasi SMA NEGERI 15 Palembang 2014

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CHAPTER I

INTRODUCTION

1.1 Background

Islamic Banks is a banking system based on the principles of Islamic law (also known as Shariah) and guided by Islamic economics. Two basic principles behind Islamic banking are the sharing of profit and loss and significantly the prohibition of the collection and payment of interest. According to Algaoud and Lewis (2005), Islamic banks provide interest-free service to their customers. Payment and withdrawal of interest is prohibited in all transaction. Islam prohibits Muslims pulling or paying interest (riba). This prohibition which distinguishes Islamic banking system compared with the conventional banking system. Islamic bank is established with the goals to promote, develop and apply the principles of Islam, sharia and its traditions into financial transactions and banking, and the other related business. The main principles followed by Islamic banks are: the prohibition of usury (riba), conducting business and trade based on legitimate profits, and giving zakat (charity).

Islamic banking appears as a response to the conventional banking which develops usuary (riba). Islamic banking is the realization of Islamic economics as the opposite of conventional economics. The term of Islamic economics recently emerge although the fact about this concept has been acknowledged since the beginning of the rise of Islam. The term of Islamic economics is originated from Islamization discourse of science which led by Al-Faruqi and Naquib Al-Attas. Islamization of science is shown to embody the awakening of Muslims in the world (Hoetoro, 2007, pg. 158).

As for Islamic Economics defines the basics collected from the Al-Quran and Hadith that is related to economic issues. For example, the words of Allah in Surah Al-Baqarah verse 275 which said:

الَّذِينَ يَأْكُلُونَ الرِّبَا لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ الَّذِي يَتَخَبَّطُهُ
الشَّيْطَانُ مِنَ الْمَسِّ ذَلِكَ بِأَنَّهُمْ قَالُوا إِنَّمَا الْبَيْعُ مِثْلُ الرِّبَا وَأَحَلَّ اللَّهُ
الْبَيْعَ وَحَرَّمَ الرِّبَا فَمَنْ جَاءَهُ مَوْعِظَةٌ مِنْ رَبِّهِ فَانْتَهَى فَلَهُ مَا سَلَفَ
وَأَمْرُهُ إِلَى اللَّهِ وَمَنْ عَادَ فَأُولَئِكَ أَصْحَابُ النَّارِ هُمْ فِيهَا خَالِدُونَ



“Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity. That is because they say, "Trade is [just] like interest." But Allah has permitted trade and has forbidden interest. So whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah . But whoever returns to [dealing in interest or usury] - those are the companions of the Fire; they will abide eternally therein.”

Also in Surah Al-Maidah verse 2 which said:

يَأْتِيهَا الَّذِينَ ءَامَنُوا لَا مُجْلُوا شَعِيرِ اللَّهِ وَلَا الشَّهَرِ الْحَرَامِ وَلَا أَلْهَدَى
وَلَا الْقَلْتِيدِ وَلَا ءَامِينَ الْبَيْتِ الْحَرَامِ يَبْنَعُونَ فَضْلًا مِنْ رَبِّهِمْ وَرِضْوَانًا وَإِذَا
حَلَلْتُمْ فَأَصْطَادُوا وَلَا يَجْرِمَنَّكُمْ شَنَاٰنُ قَوْمٍ أَنْ صَدُّوكُمْ عَنِ
الْمَسْجِدِ الْحَرَامِ أَنْ تَعْتَدُوا وَتَعَاوَنُوا عَلَى الْبِرِّ وَالتَّقْوَىٰ وَلَا تَعَاوَنُوا عَلَى
الْإِثْمِ وَالْعُدْوَانِ وَاتَّقُوا اللَّهَ إِنَّ اللَّهَ شَدِيدُ الْعِقَابِ



“O you who have believed, do not violate the rites of Allah or [the sanctity of] the sacred month or [neglect the marking of] the sacrificial animals and garlanding [them] or [violate the safety of] those coming to the Sacred House seeking bounty from their Lord and [His] approval. But when you come out of ihram, then [you may] hunt. And do not let the hatred of a people for having obstructed you from al-Masjid al-Haram lead you to transgress. And cooperate in righteousness and piety, but do not cooperate in sin and aggression. And fear Allah ; indeed, Allah is severe in penalty.”

The verses above is one of several passages relating to the economy, which meant that Allah SWT allow all kind of sale and purchase (while not against the Shari'ah) and forbidden usury and also, if we look from hadith of the Messenger of Allah, we have known that the Prophet himself was a very successful businessman. Apostle has begun trading since he was age children, and to grow up too he is still in business. And of Hadith-Hadith Prophet we can figure out how the characteristics of the Prophet trade.

Based on the two definitions above, we can draw the conclusion that Islamic economics is an economic system that is in line with Islam, and is also governed by the Shari'a in the Islamic Shari'a. That in the implementation of economic activity is not solely to make a profit, but also can be rewarding, if done with a sincere intention and to expect the pleasure of Allah SWT.

According to UU No. 21 in 2008 concerning about Islamic banking that Islamic banks have three main functions: collecting funds, distributing funds and conducting social functions. Based on these functions, Islamic bank is expected to be able to increase people's economic activities through the distribution of fund. According to Heri Sudarsono (2004, p.56), the relationship between banks and

customers in Islamic banks is not a relationship between the debtor and the creditor, but a partnership between funders (Shohibul maal) with the fund manager (mudharib), so the profit rate of Islamic banks do not only affect the rate of profit-sharing for the shareholders, but also affect the rate of profit-sharing that can be given to depositors.

The distribution of the fund in banking term is known as financing. In Islamic banking, there are several kinds of financing. In broad outline, the financing in Islamic banking are divided into three, such as financing transaction with the principle of sell and purchase (tijarah), financing transactions in leasing (ijarah), and financing with cooperation system (shirkah) (Muhammad, 2005, p.93).

According to Sani (2010), from the three types of major groups in the financing of Islamic banking, a financing with cooperation system is best suited to the main system of Islamic banking, namely profit-sharing system. This type of financing is divided into two financings, such as Mudharabah and Musharaka. However, these contracts are not contracts that nationally dominate the financing of Islamic banking. Most of the Islamic banks financing are more focused on Murabahah financing. It is visible on the statistics issued by Bank Indonesia which Murabahah has its share approximately 56% of the total financing provided by Islamic banks. While the Mudharabah only reach about 22.7% and Musharakah only reached about 14.2%.

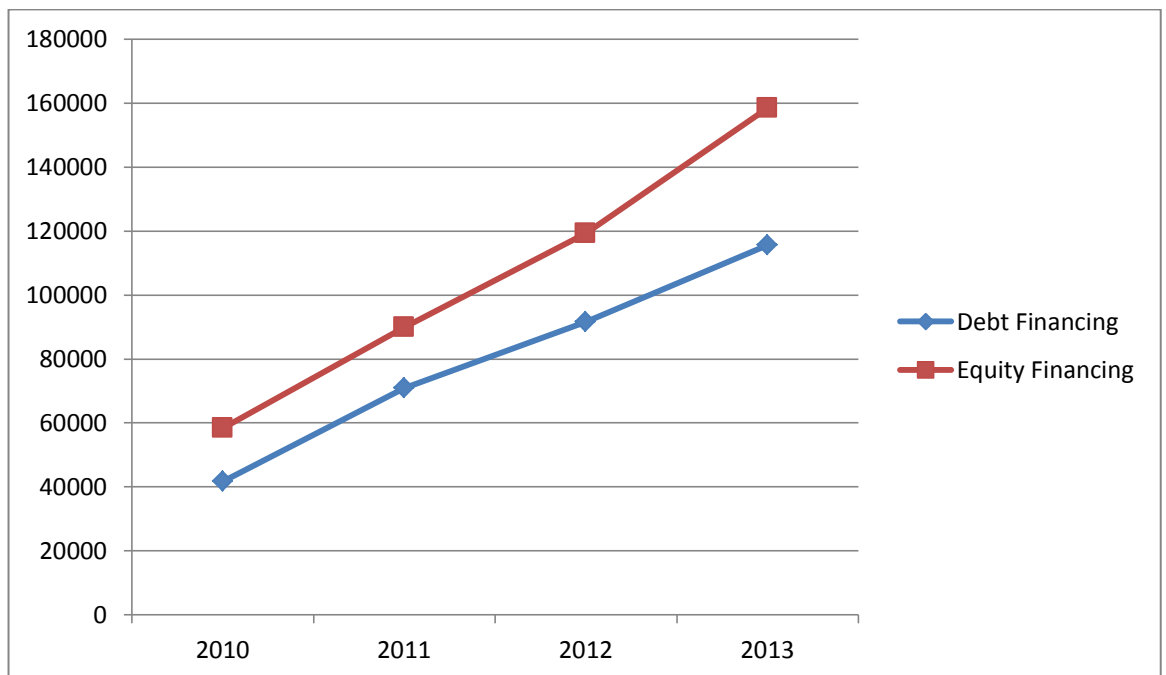
To conduct financing in Islamic banks, the source of fund mostly come from the third party fund (DPK) or derived from the customers of the bank. Islamic banks financing portion generally reach 60% of total assets. According to Karim (2005) in *Islamic Banking, Fiqh And Financial Analysis 3rd Edition*, on the basis of its purpose, sharia financing can broadly classified into four categories as follows:

1. Financing under the principles of sale and purchase (Ba'i);
2. Financing under the principles of leasing (Ijarah);
3. Financing under the principles of revenue-sharing (Syirkah);
4. Financing under complementary contracts.

In this research, increasing in asset and funding will indirectly increase the financing committed by Islamic banks through financing products such as financing with sale and purchase system (debt financing) and financing with profit-sharing system (equity financing). Both of these financings have very different characteristics that make both of these financings also has a different percentage value.

Figure 1

The Development of Debt Financing and Equity Financing



Source: Muamalat Bank & Syariah Mandiri Bank

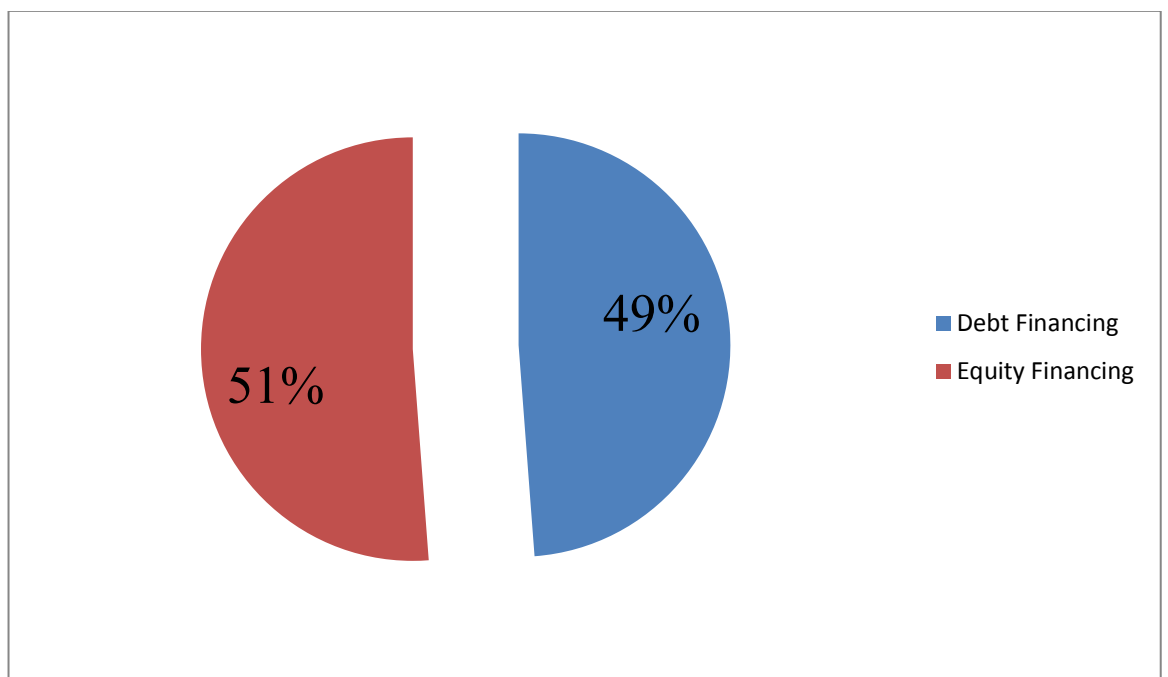
Data: in billion

Through the chart above, it shows the development of Debt Financing significantly increasing from period 2010 to 2013, financing with sell and purchase

system has increased about 26%. Also the development of Equity Financing, the chart shows a significant increase that reach about 22%. This proves that public confidence in Islamic banks become increasingly well and stronger so Islamic banks can improve their financial activities, both through Debt Financing and Equity Financing.

Figure 2

Total Financing of Islamic Banks in Indonesia
(2010-2013)



Source: Bank Indonesia (data processed)

Data: in billion

Through the chart above, it can be seen that Debt Financing and Equity Financing nearly have an equal proportion in total financing of islamic banks in Indonesia, which the total of Debt Financing is 502.538 billion rupiah or reach 49% of total financing and the total Equity Financing is 527.280 billion rupiah or reach 51% of total financing.

Figure 3

The Development of Net Profit of Islamic Banks in Indonesia



Source: Muamalat Bank & Syariah Mandiri Bank

Data: in trillion

Due to an increase in financing activities conducted by Islamic banks, the profit also increase significantly. Although in period 2009, the profit that gained by Islamic banks declined but in the following years, Islamic banks profit has increased even higher.

Financing with the principle of sell and purchase conducted by Islamic banks dominate far above the financing with profit-sharing system (Sukamto, 2010). The reason why Islamic banks prefer to choose Debt Financing in deciding the provision of financing because there is no high cost needed and a review process in advance by the bank regarding of business prospects is unnecessary, also small risk of loss because profit margins have been set in advance so Islamic banks already could

estimate the profit generated on the financing. Otherwise in deciding the provision of Equity Financing, first Islamic banks should conduct a review about the parties who will be given a financing. The review concerns the business prospects to see profitability, the condition of business to assess the ability of Islamic banks in returning a financing that results a cost and it will be an expense for Islamic banks in financing, also the profit which generated by Islamic banks can not be calculated because it depends on the business profit, and only the amount of profit percentage that can be specified. There is no risk of loss that should be shared by Islamic banks and their customers which causes the profit generated by Islamic banks decreased.

Based on the description above, the researcher intends to reexamine the influence of Debt Financing and Equity Financing on Profit Expense Ratio of Islamic banks and this research is titled **The Impact of Debt Financing and Equity Financing on Profit Expense Ratio of Islamic Banks in Indonesia.**

1.2 Statements of Research Problem

The main problems in this study is:

Do Debt Financing and Equity Financing partially and simultaneously have the effects on Profit Expense Ratio of Islamic Banks in Indonesia?

1.3 Research Objectives

1. To know the impact of Debt Financing partially on Profit Expense Ratio of Islamic Banks in Indonesia.
2. To know the impact of Equity Financing partially on Profit Expense Ratio of Islamic Banks in Indonesia.

3. To know the impact of Debt Financing and Equity Financing simultaneously on Profit Expense Ratio of Islamic Banks in Indonesia.

1.4 Benefits of Research

1. Theoretical Benefits

To enrich the concept or theory of science which contributes the development of Financial Management and islamic economics, especially for the development of islamic banks in Indonesia.

2. Practical Benefits

For decision makers, this research applies sophisticated statistical analysis and mathematical modeling to solve an array of business and organizational problems, as well as improve decision-making. As the business environment grows more complex, companies and government agencies rely on analysis to inform decisions that were once based largely on management intuition. Assessing projects as well as the allocation of the capital depends on the project requirements are some of the most crucial capital investment decisions aspects. This research also will help investors to acquire fixed assets by buying plant facilities and property, which ensure a good investment and capital investment balancing in turn.

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