Assessing the Profitability of Islamic Banks: The Role of Bank Age and Bank Performance

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Abstract. This study examines the effect of bank age and bank performance on the profitability of Islamic banks. The dependent variable in this study is profitability, while the independent variables are bank age, and bank performance. In addition, profit distribution is treated as an intervening variable. The sampling method used was purposive sampling where samples were taken with the provisions of 12 Public Islamic banks that publish annual reports from 2015 to 2017. The results of the data analysis show that bank age does not have a significant effect on profitability, but NPF (Non-Performing Financing) significant effect on profit sharing. Further, although FDR (Financing to Deposit), and CI (Cost to Income) have no significant effect on profit sharing. Finally, this study also reveals that profit sharing has a significant effect on banks profitability. The implication of theoretical and managerial practices is discussed. Building a competitive advantage to face industry 4.0, one of them with adopting technology is very important for Islamic banking to improve the performance of Islamic banks, improve efficiency and productivity, which will certainly support the performance of profitability.

1. Introduction
The development of Islamic banking in Indonesia is still far from expectations. A large market in Indonesia, if you see the Muslim population which is the largest in the world, does not guarantee the rapid development of Islamic banking [1]. In fact, the financial performance of Islamic banks is not as good as conventional banks. So far, the aspirations to reach a market share above 5% have indeed been fulfilled. That is because there is a conversion of conventional commercial banks to sharia. Not because of organic growth. Market penetration of Islamic banking are already slightly enlarged, but the quality has not shown improvement. The performance of Islamic banking has not improved since 2013. This can be seen from the graph of Islamic banking profitability reflected in the return on assets (ROA) which continued to decline. In 2013 Islamic banking ROA was still perched at 2.14%, the following year it declined and continued to decline until the peak occurred in 2014 with a 0.79% ROA. In 2017 Islamic banking ROA amounted to 1.17%. In quality, Islamic banking has not improved. The potential for developing Islamic banking in Indonesia is indeed relatively large. The Muslim population in Indonesia is the majority with policy support from the Indonesian Ulema Council (MUI) which states that bank interest is riba. However, the development of Islamic banking is not fantastic in terms of quality [2].

The profitability of Islamic banking is influenced by several factors including the profit distribution provided by Islamic banks. The profit sharing provided by the bank is one of the considerations for the fund owner or Shahibul Maal to save funds in Islamic banks. One effort that can be done to achieve optimal results is to increase transparency to the Shahibul Maal. Transparency has an important influence on accounting regulations and also investor profits [3]. On the other hand, the performance also affects the revenue sharing. Banking financial performance is a major factor and it is very important
to assess the overall performance of the bank itself. In order to compete with conventional banks which have dominated the banking industry in Indonesia so far, Islamic banks must try to improve their financial performance, including the ability to manage funds and provide maximum profit sharing. The assessment of financial performance on the ability of Islamic banks to generate profits is very beneficial for banks and bank partners. By looking at the financial performance trends, Islamic bank partners can decide on a partnership policy model with banks. Shariah equity law expresses the need for a fair and equitable sharing of profit and loss between depositors and banks, whatever the form of financing used [4].

Experience in running a business for banks will affect the existence of banks in the face of competition. The age of the company is able to show information that can be obtained by prospective investors. Newly established banks must be able to take actions that build trust for their stakeholders [2]. From previous studies, it was found that the age of the company is one of the most important factors that determine the growth of the company, the diversity of the company's growth and the possibility of the company being dissolved. The age of the company is one of the important attributes of the company’s performance because it explains the experience of the company in managing the company [3, 5]. The results of this study are expected to be a reference for the management of Islamic banks to establish good corporate governance in order to achieve a satisfactory level of profitability.

1.1 Effect of bank performance on profit distribution
Performance is the way, behaviour, and ability to work. Financial performance is an aspect that is considered by the company by supervising a financial report. Previous research examined the existence of an indirect relationship between performance and profit allocation. In other words, the researchers argued that the mechanism of corporate governance affects the performance of companies that have an effect on the distribution of profits, especially in the form of dividends. A scholar [6] states that Islamic banks maintain savings from profits generated for smooth returns or cover periodic losses to compete with the interest rates offered by non-Islamic banks. This was triggered by the sharing of revenue with Shahibul Maal. According to [3] Islamic banks are able to manage the level of profits allocated to IAHs (Investment Account Holders) based on market conditions.

The company can measure its performance level using ratios. This ratio is measured using the data taken in the annual financial statements of the companies involved. In addition, ratios can also be used to monitor developments in the company’s finances. One model used in measuring the performance of companies, especially Islamic banking, is the ratio. According to [3] banking performance is estimated to have a strong correlation with profit sharing. Actually, in the case of Islamic bank performance, there is no room for manipulating profits. However, in the case of low bank performance, Islamic banks tend to make profit-sharing estimates to maintain their profits as mudarib. In bad economic conditions, Islamic banks tend to perform poorly and cause losses to the Shahibul maal. While in the research [7] performance consisting of CAR, NPF, NIM as the independent variable has a positive effect on profit distribution. The CI variable has a significant negative effect, while the performance variable consisting of LA and SEN has no effect.

1.2 Bank age relationship to profit distribution
Experience in running a business for banks will affect the existence of banks in the face of competition. The age of the company is able to show information that can be obtained by prospective investors. According to [2] in the context of the bank, the new bank is the same as the newly established company. The newly established bank lacks information about the condition of the bank itself. Newly established banks must be able to take actions that build trust for their stakeholders.

A researcher [2] argues that it is difficult for companies to start their business operations primarily to gain profits in the early years of their operations. For Islamic banks, this is a bad thing, especially because of the use of profit sharing systems. The difficulty of getting profits will make the profit sharing smaller, this will result in depositors withdrawing their funds and transferring them to banks that provide
better returns (displacement funds). When associated with stakeholder theory, then in order to reduce this risk, Islamic banks will maintain or increase the PDM level to build trust in their depositors.

From previous research found that the age of the company is one of the most important factors that determine the growth of the company, the diversity of the company's growth and the possibility of the company may be dissolved. The age of the company is one of the important attributes of the company's performance because it explains about the experience that the company has in managing the company [3, 5]

1.3 Effect of profit distribution on profitability
Profit distribution is a profit or result obtained from the management of funds both investment and sale and purchase transactions given to customers [7]. Profit sharing affects the profitability of Islamic banks due to securing Shahibul Maal funds. Banks must maintain the level of profit sharing so that the funds can be channelled to financing that will provide returns on profits for the bank.

1.4 Effect of bank performance on profitability
Bank performance is a barometer of the business competition's ability of the bank. Bank performance is also an important aspect that must be known by stakeholders [8]. In research, the determinants of profitability of Islamic banks in Indonesia show DPK, NPF, FDR, BOPO, and SWBI simultaneously influence ROA. For partial results, DPK, FDR and BOPO variables negatively affect ROA. While for NPF and SWBI variables have a positive effect on ROA. While the research shows partially BOPO and CAR does not affect the ROA ratio, the NPL ratio, and the LDR ratio significantly influence the ROA ratio.

Based on the research model, 5 hypothesis to be tested. The first hypothesis is the performance of banks with NPF measurement has a negative effect on profit distribution. The second hypothesis Bank performance with CI measurement has a positive effect on profit distribution. The third hypothesis Bank performance with FDR measurement has a positive effect on profit distribution. Bank age has a positive effect on profit distribution. Profit distribution has a positive effect on bank profitability (see Figure 1).

Figure 1. Research model.

2. Method
Based on the title of the research that has been taken then the variables examined in the study was Independent Variables (exogenous), namely Bank Performance with proxy NPF, CI, and FDR. The Dependent variable (endogenous) in the form of Profitability is represented by the ROA proxy and the intervening variable by Profit Distribution which is proxied by the Profit Distribution Ratio. The population in this study was in the form of all sharia commercial banks for the last 3 periods from 2015 to 2017, totalling 13 sharia commercial banks. The sample in this study is a sharia commercial bank that publishes an annual report for the last 3 periods from 2015 to 2017, totalling 12 Islamic banks.
The data source used in this study is secondary data. Secondary data in this study were obtained from annual reports published by Islamic banks collected by documentation techniques. According to experts [9, 10], the model used in this study used is path analysis. Path analysis is the development of a regression model, so regression analysis can be said as a special form of path analysis (regression is a special case of path analysis) [11]. Path analysis is used to describe and test the model of relationships between variables in the form of cause and effect. Through this path analysis, it can be found which path is the most appropriate and shortest for an independent variable towards the last dependent variable. [11] The analysis tool used in this study is WarpPLS (Partial Least Square). PLS uses random multiplication methods. Therefore the assumption of normality will not be a problem for PLS. Aside from being related to data normality, by randomly multiplying the PLS does not require a minimum number of samples [12].

3. Results and Discussions
Testing is done using the SEM (Partial Least Square) method. The use of SEM is done because the data normality test shows that the data analysed is not normally distributed so that the most suitable for testing the model is using SEM. Tests are carried out on five variables whose exogenous variables (profitability) the rest are endogenous variables, while 1 is an intervening variable, namely profit distribution. This test was conducted to determine the effect of bank age variables and performance on the independent variable, namely profitability mediated by profit distribution. The results of the analysis can be seen in Figure 2 and Tables 1 and 2.

![Figure 2](Image)

**Figure 2.** The result of testing the proposed model.

| Table 1. Value of p value. |
|---------------------------|
| NPF | CI | FDR | Bank Age | PDR | ROA |
|-----|----|-----|----------|-----|-----|
| PDR | <0.001 | 0.448 | 0.077 | 0.075 | <0.001 |
| ROA | <0.001 | |

| Table 2. Parameter coefficients. |
|----------------------------------|
| NPF | CI | FDR | Bank Age | PDR | ROA |
|-----|----|-----|----------|-----|-----|
| PDR | -0.73 | 0.02 | -0.22 | 0.22 | 1.00 |
| ROA | |

The performance measurement of Islamic banks is using the financing ratio, namely NPF (non-performing financing). The results of NPF testing indicate that NPF has a parameter coefficient of -0.73
with a p-value <0.1 indicating that the NPF variable is significant at 5 percent. The results of this study are in accordance with research [13] and [1]. The lower NPF or financing problems indicate that Islamic banks have good financing activities because of the existence of safe capital adequacy. So that it can encourage an increase in profits and increase profit distribution.

The next proxy is CI (cost to income ratio). CI has a parameter coefficient of 0.02 p-value of 0.448. Positive parameter coefficient values indicate that CI has a positive effect on profit distribution. The results of this study are not in accordance with the research of Lachrech et al., (2014). This is because the greater the cost or cost, the greater the profit or income earned. The costs incurred are of course widely used to support the smooth running of Islamic bank business activities so that it will make the level of profit distribution increase.

The next proxy is FDR (Financing to Deposit Ratio). FDR has a parameter coefficient of -0.22 p-value of 0.08. The p-value value shows no significant level of 5 percent. The negative parameter coefficient value indicates that FDR has a negative effect on profit distribution. The greater the FDR, the smaller the level of profit distribution. This is because the greater the FDR, the Islamic bank does not have sufficient liquidity to cover its obligations to customers of deposits (Third Party Funds).

Based on the results of testing the fourth hypothesis using the bank age variable obtained the parameter coefficient value 0.22 with p-value 0.08. The p-value value shows no significant level of 5 percent. So it can be concluded that the age of the bank has a positive effect on profit distribution management. The longer the age of the bank is more mature in good governance in its activities, the experience of an old Islamic bank can be a capital to deal with all the risks that occur.

Based on the results of testing the fifth hypothesis using the profit distribution ratio variable, the parameter coefficient value 1.00 is obtained with p-value <0.01. The p-value value shows a significant level of 5 percent. So it can be concluded that the profit distribution ratio has a positive and significant effect on the profitability of Islamic banks. With a promising level of profit sharing, it is able to attract customers of Shahibul Maal to save their funds and be managed by Mudarib, namely Islamic banks to be channelled to financing.

Investors and depositors have sufficient strength and resources to supervise profit distribution. Efficient bank performance will encourage management to carry out profit distribution. So that management will try to carry out good managerial functions and improve performance to increase profit distribution. This is because a high-profit distribution will attract the trust of investors and depositors to always invest. This shows that the level of profit sharing provided by Islamic banking has a significant effect on the profitability of Islamic banks. The higher the return generated signifies good performance, the higher the value created for shareholders, the more willing to share part of this value with depositors [15].

The results of this study are consistent with the research of Lachrech et.al [3]. This results explain that the higher the level of performance has an impact on the higher profit distribution carried out by Islamic banks to customers. With the high performance of the bank, it will increase the profit distribution which has an impact on increasing customer trust. Meanwhile, the age of Islamic banks has a positive, but not significant, effect on the way Islamic banks. The age of the company is one of the most important factors that determine the growth of the company, the diversity of the company's growth and the possibility that the company can be dissolved. The results of this study are different from the research conducted by Farook and Hassan regarding the influence of the age of Islamic banks on the profit distribution, which the influence is negative [5].

4. Conclusion
The profit distribution system applied by Islamic banks is very influential on profitability because it can attract Shahibul Maal to save or invest funds in Islamic banks. With the high performance of the bank, it will increase the profit distribution which has an impact on increasing customer trust. Meanwhile, the age of Islamic banks has an effect even though it is not significant in the way of managing the Islamic banks. The age of the company is one of the most important factors that determine the growth of the company, the diversity of the company's growth and the possibility that the company can be dissolved.
The management of Islamic banks, thus, must develop a good corporate governance in order to achieve a satisfactory level of profitability. Further, it will attract Shahibul Maal or depositors to invest and save their funds in sharia commercial banks. Adoption of technology will also improve both the banks’ front office and back office. The transformation of technology and various derivative instruments and liquidity will support performance, increase efficiency and productivity, which will certainly support the bank profitability.

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