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Sharia Compliance and Profitability in Financial Performance Islamic Banks in Indonesia

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Abstract: This study sought to evaluate the financial performance of Islamic commercial banks in Indonesia from 2018 to 2022, with a specific focus on Sharia compliance and profitability. Secondary data taken from the annual reports of commercial Islamic banks during the specified period were used and a descriptive quantitative approach was adopted. The study population consisted of all 13 Islamic commercial banks registered with the Financial Services Authority in 2022; eight banks were chosen as the research sample. The analysis method used encompasses both Sharia compliance and profitability and is called the Sharia Compliance and Profitability Model. For further analysis, the research findings were divided into four quadrants. The results of the study showed how different Islamic commercial banks in Indonesia performed in terms of Sharia compliance and profitability. It identified banks that showed strong adherence to Sharia principles and high profitability, which could be used as benchmarks by other banks to improve their performance. In more detail, The findings of this research included 3 aspects, namely 1) Identification of Sharia Compliance, this study identified the parameters used to assess Sharia compliance, such as compliance with the principles regulated by the Indonesian Ulema Council (MUI) or equivalent Sharia regulatory institutions. The results of this research revealed banks that consistently complied with Sharia principles in their operations and products. This could include

banks that had a financial structure that complied with Islamic law, avoids usury, and adhered to the principles of fairness in transactions. 2) Profitability Assessment. Financial analysis has been carried out to assess the profitability of the investigated banks. This could include profitability ratios such as ROA (Return on Assets) and ROE (Return on Equity), as well as the profit growth from year to year. 3) Factors that influenced the Performance as well as the analysis also included an exploration of factors that contributed to bank performance in terms of Sharia compliance and profitability. This could include internal factors such as risk management and operational efficiency, as well as external factors such as market conditions and regulations. The research has practical implications for commercial banks for enhancing performance and adhering to Islamic values in highly profitable banks that strictly adhere to Sharia principles. By examining the connection between Sharia compliance and profitability, this study added to the understanding of the financial performance of Indonesia's Islamic commercial banks.

Keywords: Sharia Conformity and Profitability Model, Financial Performance.

Introduction

From a broad perspective, the banking sector plays an important role in advancing the economic structure of a country because a healthy financial system is closely related to the functioning of banks. Therefore, every banking industry needs to contribute to all levels of society. In order to establish a robust economic structure that aligns with multifaceted development challenges and a fiercely competitive financial landscape, banks must fulfill their role as intermediary institutions by responsibly collecting and channeling funds to the public.

Given the very important role of banking in managing and collecting funds from the public, the government maintains a high level of concern regarding the operational activities of the banking industry. As a consequence, various regulations are needed to maintain banking stability. One of these regulations focuses on maintaining the health of sharia banking so that it can operate smoothly and carry out the precautionary principle in accordance with applicable regulations. In adhering to the principle of prudence in conducting their business, banking institutions must prioritize maintaining liquidity and diversifying risks. Efficiency in the banking sector can be seen through profitability and increased movement of funds from surplus areas to areas in need. Profitability serves as an indicator of effective bank management so that it can show a positive correlation between liquidity and bank performance.

The development of Islamic banking in Indonesia has shown progressive growth. We can see this from the achievement of market share for Islamic banks in the last five years (2018–2022) with an average market share of 6.40 %. Even though there has been an increase, this cannot be said to be optimal, considering Indonesia has a Muslim-majority population. But on the other side, This increase in market share is good news for Islamic banking in Indonesia because, in the previous year, the national banking industry experienced obstacles in its growth due to the covid-19 pandemic.

Even though there has been an increase, this cannot be said to be optimal, considering Indonesia has a Muslim-majority population. But on the other side, this increase in market shares is good news for Islamic banking in Indonesia because, in the previous year, the national banking industry experienced obstacles in its growth due to the covid-19 pandemic. This market shares gain was supported by 13 Islamic banking institutions operating in Indonesia.

Apart from the three things above, there are several indicators used to measure the achievement of financial performance by banks. But the above aspects are essential things that can measure to assess financial performance. However, it is different from Islamic commercial banks, which require a separate

analysis to see developments over a certain period so that the development of Islamic retail banks by measuring financial performance in terms of conventional and sharia to obtain more effective results.

Measurement serves various functions, including assessing the institution's performance, particularly within the financial sector, and determining whether the attained results have met the targets. Therefore, performance measurement analysis needs to be carried out using various calculation methods, both conventional and sharia, to produce useful information and serve as evaluation material for the bank.

The evaluation of Islamic banks' performance has been the subject of numerous studies. However, the majority of these studies utilise financial performance appraisal standards that have been replicated and adapted from traditional banks, such as CAMELS (Capital, Asset, Management, Earnings, Liquidity, Sensitivity to Market Risk), RGEN (Risk Profile, Good Corporate Governance, Earnings, Capital), and EVA (Economic Value Added). Since Islamic banks are a subsystem of Islamic economics, the performance assessment is based on traditional bank benchmarks and does not reflect actual performance. Additionally, as both have unique characteristics, it is unwise to compare Islamic banks' performance to that of ordinary banks when evaluating their performance.

However, this measurement is considered to have weaknesses, including the absence of different benchmark characteristics between conventional and Islamic banks. And also, in this measurement, financial ratios are the primary determining factor of a company's performance. As a result, these results make managers ignore short-term plans and only focus on long-term objectives.

Therefore, an analysis is needed to assess the financial performance of Islamic banking, which not only emphasizes profit generation but also evaluates the aspect of fulfilling Islamic objectives. This is fundamental to the operation of banks aiming to achieve the goals of Islamic finance, primarily to provide societal benefits.

The Shariah Conformity and Profitability (SCnP) Model is one of the instruments used to gauge the performance of Islamic banks. The SCnP model is a research tool that Kuppusamy et al. (2010) utilised to evaluate the financial performance of banks. This model combines the exposure of the conformance index to the sharia system with its orientation on profitability measures used to evaluate conventional financial arrangements. This approach, according to Kuppusamy and associates, integrates two fundamental Islamic banking orientations: the Islamic side of the bank and the bank's financial side, making it a more accurate measurement. Following scholars have been motivated by research employing the SCnP model, including Al-Ghifari et al. (2015), Muchtar and Rofi (2020), Prasetyowati and Handoko (2019), Ratnaputri (2013), and Siregar and Shifa (2021).

Problem Statement

Despite the rapid growth of Islamic banking in Indonesia, there is still a crucial need to comprehend the correlation between Sharia compliance and financial performance, especially profitability, within this sector. While Islamic banks are mandated to operate in accordance with Sharia principles, the extent to which the adherence to these principles impacts their profitability requires deeper investigation. Therefore, this study aimed to examine the interplay between Sharia compliance and profitability in the financial performance of Islamic banks in Indonesia. By addressing this gap in the literature, insights can be gained to inform strategic decision-making for both Islamic banks and regulatory authorities, fostering a more sustainable and competitive Islamic banking industry.

Research Focus

The study highlighted the importance of sharia compliance and profitability in Islamic commercial banks. It emphasised the need for these banks to balance financial success with adherence to Islamic principles, ultimately contributing to developing a more ethical and responsible banking sector, thus the

aim of this study was to examine and measure the financial performance of Islamic commercial banks in Indonesia in terms of Islamic suitability and profitability for the 2018-2022 period.

Research Aim and Research Questions

This study focused on exploring the relationship between sharia compliance and profitability in the financial performance of Islamic banks in Indonesia, as well as its practical implications for the Islamic banking industry as a whole. The research questions in this study were: 1) How is the level of sharia compliance of Islamic banks in Indonesia measured and how is it related to their financial performance, 2) How does the financial performance compare between Islamic banks that have a high level of sharia compliance and banks that have a low level of sharia compliance?

Literature Review

Given the complexity of the challenges encountered by Islamic banking, a comprehensive measurement tool is necessary, incorporating various approaches including financial ratios and the Islamic perspective. Islamic economists have employed diverse methods to gauge the performance of Islamic banks. Mursyid et al. (2021) and Rianto et al. (2022) introduced the Shariah Maqashid Index (MI), Kuppusamy et al. (2010) introduced the Shariah Conformity and Profitability (SCnP). The Shariah Conformity and Profitability (SCnP) model is the approach being used here. Islamic compliance and profitability were two essential Islamic banking metrics that were combined in this measurement. Six ratios were separated into two indicators in the SCnP model. There were ratios of Islamic investment, ratios of Islamic income, and ratios of profit sharing as measures of adherence to the sharia (shariah conformance). The profitability indicator also included a profit margin ratio, a return on equity (ROE) ratio, and a return on assets (ROA) ratio.

However, to enhance the calculation of the profitability indicator, the researchers included the Capital Adequacy Ratio (CAR) as an additional factor in measuring a bank's financial performance. Consequently, a total of seven ratios were utilized in this study. The following is an explanation of the seven ratios.

Sharia Investment

In Arabic, investment is referred to as "Istithmar", which signifies making it fruitful and increasing in number (Muda, 2003). The purpose of spending on investment is the purchase of goods that give the hope of producing future profits. That is, the considerations entrepreneurs or companies take in deciding to buy or not to purchase these goods and services are the expectations of entrepreneurs or companies about the possible benefits they can obtain. This profit expectation is a significant factor in investment (Pardiansyah, 2017).

There are two types of investment: direct investment, such as business ventures in the real estate industry, and indirect investment. Investments in non-real sectors include deposits in Islamic banking and acquisitions in the Islamic stock market, Islamic mutual funds, Sukuk, SBSN, and other Islamic capital markets (Kammer et al., 2015).

Sharia investment is based on sharia principles, both in the real sector and the financial industry. So, one cannot separate that investment from Sharia principles, ensuring that the purpose or intention of speculation in business and investment does not conflict with Sharia as well as separate all business activities from uncertainty, namely the possibility of profit or loss of a company, so humans speculate in determining their business investment choices, regardless of the profit or loss. This means that any business contains uncertainty of profit or loss.

Sharia-compliant investment entails placing funds in one or more assets, and this activity must also avoid elements of gharar, maysir, and usury. Measuring the value of the Islamic investment ratio in

the SCnP model is done by comparing Islamic investment with Islamic investment plus non-Sharia investment.

Sharia Income

Islamic banks are one of the financial institutions that facilitate economic mechanisms in the real sector through business activities such as investment, purchase, lease, or others according to Islamic religious principles. The principle of the Islamic religion instructs an agreement based on Islamic law between banks and other parties in depositing funds and or financing business activities and other activities following Islamic values according to the Financial Services Authority (Yunita & Syaichu, 2017).

Sources of income for sharia banks are obtained from 1) Profit margin based on sales and purchase agreements, 2) Rental income based on ijarah agreements, 3) Income based on profit sharing financing (Mudharabah and musyarakah), 4) Principles of service/wages based on fee agreements

The income from profit-sharing products owned by the bank plus other payments is referred to as sharia income in the financial statements of Islamic banks. Income earned by the bank for the issuance of finance is referred to as sharia income. In addition to Sharia income, non-sharia income from charitable funds is also shown in the financial statements of Sharia banks under the heading non-halal payment.

To obtain the value of the sharia income ratio was evaluated by comparing sharia income and sharia income added to the non-sharia payment. 40 Part of the financial statements that was the basis or measure of sharia income is the bank's profit-sharing rights added to other income. At the same time, non-sharia income was obtained from non-halal income or sources of benevolent funds contained in the annual reports of Islamic banks.

Profit Sharing

According to Hambly et al. (2019) and Rynes et al. (2005) the profit-sharing is an organisationally oriented incentive that links compensation with overall performance, merit pay, and personal and other conditions of group incentives. The critical distinction between different types of compensation that may concentrate on payments to individuals or teams for individual or collective work is that it constitutes a contractually based surplus sharing.

Islamic banks offer the mudharabah contract, an example of the Islamic paradigm of profit sharing (Kusuma et al., 2018; Trisanty, 2018). The activity in Sharia banks, particularly fund distribution or financing, is dominated by Akad of profit sharing since it implements a profit sharing concept (Hadi, 2011). The idea of sharing profit loss is one of Islamic finance's features. The way Islamic banking operates differs from traditional banking because of this feature. Most Islamic banking activities, particularly those involving cash distribution or financing, are governed by profit-loss-sharing agreements, which implement the concept of profit-loss sharing. However, murabahah and other features that involve non-profit-sharing contracts are the most prevalent in Islamic banking today (Karim, 2011).

The profit-sharing ratio was a comparison between bank activities in the form of cooperation with other parties, while the types of products in the bank were mudharabah and musyarakah. The value of this ratio was obtained by adding up the two products with total financing. With this indicator, the level of sexiness of a bank in sharing its profits with investors was found out (Prasetyowati & Handoko, 2019). For the profit sharing ratio, the value was obtained in the financing section of mudharabah and musyarakah products contained in the annual report of Islamic banks.

Return on Assets (ROA)

Financial performance in the banking industry is evaluated through financial reports. Financial ratios can generally be used to calculate the financial performance of banks. Financial ratios, typically expressed quantitatively in percentages or times, are the results of calculations between two forms of economic data. This demonstrates how financial ratios can be used to evaluate a banking company's financial health (Abdul Hadi et al., 2018; Pattiruhu & Paais, 2020).

The return on assets ratio evaluates a bank's ability to generate profits from its total asset base. This ratio evaluates an organisation's capacity to produce net income under specific conditions (Khamisah et al., 2020). According to Setyawati et al. (2017) the bank's ROA level demonstrates the management's capacity to control funds and direct them toward promising and secure financing industries. In addition, (Harianto, 2017) states that a bank's ability to optimise predicted profits will lead to substantial financial results and raise public confidence in Islamic institutions. One can determine the ratio's value by comparing the bank's net income with the total assets it possesses.

Return on Equity (ROE)

Despite the potential for negative outcomes (Ichsani & Suhardi, 2015), return on equity remains the ratio utilized to measure a company's effectiveness in generating profits for its shareholders (Mardianto, 2009). Puspitasari et al. (2023), Warrad (2015), and Yucel and Kurt (2002), demonstrated a positive correlation between the net operating cycle and liquidity ratios and a negative correlation between the net operating cycle and returned on assets (ROA) and equity (ROE). The high leverage ratio hurts the company's liquidity and profitability.

The high ROE shows that the business made a profit with its capital. The value of selling the company will increase as ROE increases, which will undoubtedly affect stock price (Kamar, 2017). In this study, the ROE ratio was used to gauge the financial performance of banks by comparing net income to shareholder capital.

Capital Adequacy Ratio (CAR)

According to Aspal and Nazneen (2014), Handoyo et al. (2023), and Olarewaju and Akande (2016) the capital adequacy ratio (CAR) is the ratio that regulatory authorities in the banking sector use to evaluate the soundness of the banking system and make sure that banks can calculate their level of capital adequacy from the possibility of losses resulting from bank operations.

Additionally, it was claimed by (Usman & Lestari, 2019) that the capital adequacy ratio (CAR) is a crucial gauge of bank safety sustainability. Banks that can guarantee CAR have the strength to withstand the financial crisis, safeguarding their assets and depositor money. But first, according to (Dang, 2011), a bank's capital adequacy ratio demonstrates its internal capacity to withstand the losses experienced during a crisis.

A bank's capital determines its ability to absorb losses from risky investments, safeguarding against adverse impacts on the bank's financial stability. Calculate CAR's value by multiplying the difference between capital and risk-weighted assets (AMTR) one hundred percent. If the CAR obtained is also substantial, it indicates an improvement in the bank's soundness level (Fauzi et al., 2020).

Profit Margins

The profit Margin is a profitability ratio whose value is obtained by comparing the income or net profit with payments received to determine how much actual income the company earns. One of the financial performance indicators, according to Budiyanta (2021), is the net profit margin; Killingsworth and Mehany (2018) explained that NPM has a significant positive effect on gross profit.

According to Bionda and Mahdar (2017), the Net Profit Margin concurrently has a favorable and considerable impact on earnings growth. Based on the research by (Wahyuni et al., 2017), that affects

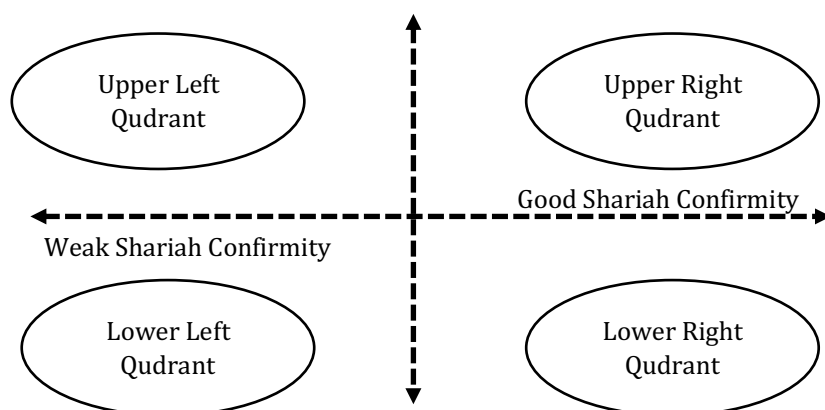
earnings growth that is both favourable and significant. However, this runs counter to Wardhani's (2019) research findings, which claim that Net Profit Margin has little to no impact on changes in earnings.

According to Bougatef & Korbi (2018), risk aversion, inefficiency, diversification, and economic conditions may all contribute to the net profit margins of Islamic banks. For conventional banks, market concentration and risk aversion have a favorable role, whereas specialisation, diversification, inefficiency, and liquidity play a negative role.

Research using the SCnP model divides the financial performance results of Islamic banks into four quadrants which are interpreted into a graph of the SCnP model (Fig. 1). The four quadrants are as follows:

Figure 1

Quadrants of the Islamic Banks' Performance Results



- a. Upper Right Quadrant (URQ) is a quadrant that shows that Islamic banks have high Islamic conformity and also high profitability.
- b. The Lower Right Quadrant (LRQ) is a quadrant that shows that Islamic banks have high Islamic conformity, but low profitability.
- c. The Upper Left Quadrant (ULQ) is a quadrant that shows that Islamic banks have high profitability, but have low sharia conformity.
- d. The Lower Left Quadrant (LLQ) is a quadrant that shows that Islamic banks have low Islamic conformity and low profitability.

Methodology

The study design was descriptive quantitative, and secondary data from the annual reports of Indonesia's Islamic Commercial Banks for the years 2018 through 2022 were gathered from the organisation's website. The population of this study consisted of all 13 Islamic Commercial Banks registered with the Financial Services Authority in 2022. The purposive sampling is a technique for taking specific criteria and conditions, and it was employed in this study as the sampling strategy. The following measures were used to choose the sample: 1) Islamic Commercial Banks recorded or registered with OJK institutions between 2018 and 2022; 2) Islamic Commercial Banks operating for over three years. 3) Islamic Commercial Banks that have released annual reports from 2018 through 2022; 4) Islamic Commercial Banks contain data necessary for study in their annual reports. After analysing 13 Islamic Commercial Banks in Indonesia, the obtained results were that the selected eight banks to be the sample met the above criteria, and the other four banks were not set. The objects in the research were (Table 1):

Table 1*Sampling Islamic Commercial Banks*

No	Name	Acronym
1	PT. Bank Aceh Syariah	BAS
2	PT BPD Nusa Tenggara Barat Syariah	BPDNTBS
3	PT. Bank Muamalat Indonesia	BMI
4	PT. Bank Jabar Banten Syariah	BJBS
5	PT. Bank Mega Syariah	BMS
6	PT. Bank Panin Dubai Syariah, Tbk	BPDS
7	PT. Bank Syariah Bukopin	BSB
8	PT. BCA Syariah	BCAS

Source: Prepared by the authors.

The data in this study were taken in a time series, meaning that collected the data based on time levels, be it weeks, months, or years. Sharia Conformity and Profitability Model is an analysis technique used in this research. This technique combined two orientations, namely compliance with sharia and profitability. Research using the Sharia Conformity and Profitability model was classified into four quadrants: URQ, LRQ, ULQ, and LLQ. The following were the stages in the SCnP model research: 1) Find and add up the values of the six ratios in the SCnP model; 2) Use the formulas below to find the average value of each ratio. The formula was as follows:

$$X_{Sc} = \frac{R_1 + R_2 + R_3}{3}$$

$$X_{Sp} = \frac{R_1 + R_2 + R_3 + R_4}{4}$$

Information:

X_{Sc} = The average value of the Shariah Conformity indicator

X_{Sp} = Average Profitability indicator value

Variable X_{Sc}

R_1 = Sharia Investment Ratio

R_2 = Sharia Income Ratio

R_3 = Profit Sharing Ratio

Variable X_{Sp}

R_1 = Return on Assets (ROA) Ratio

R_2 = Return on Equity (ROE) Ratio

R_3 = CAR ratio

R_4 = Profit Margin Ratio

After getting the value from the calculation above, the X_{SC} result was the X line's coordinate point, which was part of the Shariah Conformity indicator. At the same time, the results on X P became coordinate points on the Y line, which was part of the Profitability indicator; 3) Create SCnP Graphs and

interpreted the results obtained according to the applicable theory. The conditions for placing a bank's position in this analysis were determined based on a) the bank was in the URQ section if the accumulated results of the sharia compliance indicator and the profitability indicator were higher than the coordinate points; b) The bank was in the LRQ section if the results obtained from the sharia conformity indicators were high from the coordinate points, but the profitability indicators owned were lower than the coordinate points; c) The bank was in the ULQ section if the results obtained on the sharia compliance indicator were lower than the coordinate points, but the profitability indicator was higher than the coordinate points; d) The bank was in the LLQ section if the results obtained on the sharia conformity indicator and the profitability indicator were lower than the coordinate points.

Results

Sharia Compliance Of Islamic Banks In Indonesia

Financial Performance of Islamic Commercial Banks. Sharia investment, income, and the profit sharing are three crucial indicators of Sharia compliance that can be used to evaluate the financial performance of Islamic commercial banks. Sharia investment refers to allocating money in accordance with Islamic principles and avoiding stakes in industries that are outlawed by Islam, including gambling, alcohol, and interest-based financial instruments. Instead, Islamic banks make investments in halal (allowed) industries like manufacturing, real estate, and ethical finance.

The assessment of Sharia investment involved analysing the composition of the bank's investment portfolio and evaluating its adherence to Islamic principles. The ratio may be calculated by dividing the value of Sharia-compliant investments by the total investment portfolio. A higher ratio indicates greater Sharia compliance in the bank's investment activities.

The sources of income made by the Islamic commercial banks were evaluated by Sharia Income. These included earnings from financing, trade-based, and Sharia-compliant investment. The total income from Sharia-compliant sources was divided by the bank's overall income to determine the Sharia income ratio. A higher ratio demonstrated the bank's adherence to Islamic principles by showing that more revenue was coming from activities that comply with Sharia.

A fundamental of Islamic finance is the profit sharing, according to which Islamic banks share profits with their depositors or partners in accordance with predetermined profit-sharing ratios. This indicator evaluates how closely Islamic banks follow the concepts of profit-sharing and equitable profit distribution. A higher ratio denotes a greater focus on revenue-sharing and fair stakeholder compensation.

The following is the average value of the ratios of Islamic commercial banks from 2018–2022 (Table 2).

Table 2

Average Value of the Ratios of Islamic Commercial Banks from Years 2018–2022 (%)

Bank	Sharia Investment	Sharia Income	Profit Sharing	SC
PT. Bank Aceh Syariah	100	99.52	10	69.8
PT. BPD Nusa Tenggara Barat Syariah	100	99.71	42	80.6
PT. Bank Muamalat Indonesia	100	99.95	49.33	83.1
PT. Bank Jabar Banten Syariah	100	99.90	30	76.6

PT. Bank Mega Syariah	100	99.94	33.33	77.8
PT. Bank Panin Dubai Syariah, Tbk	100	99.70	90	96.6
PT. Bank Syariah Bukopin	100	99.71	63.67	87.8
PT. BCA Syariah	100	99.71	59	86.2

Source: Prepared by the authors.

The table above shows that the Islamic investment ratio owned by the eight Islamic commercial banks reached 100% because they did not have non-sharia investments. The highest result for the Sharia Income ratio was obtained by the Bank Muamalat Indonesia (BMI) with a value of 99.95%. In comparison, the lowest result came from the achievement of the Bank Aceh Syariah (BAS), with a discount of 99.52%. As for the Profit Sharing ratio, the highest yield was achieved by the Bank Panin Dubai Syariah (BPDS) with a value of 90%. At the same time, the lowest result is the Bank Aceh Syariah (BAS), with a discount of 10%.

On the SC indicator, the highest score was obtained by the Bank Panin Dubai Syariah (BPDS) with a value of 96.60%, then in second and third place by the Bank Syariah Bukopin (BSB) and the Bank Central Asia Syariah (BCAS) with a value of 87.80 each % and 86.20%, for the fourth and fifth positions by the Bank Muamalat Indonesia (BMI) with a score of 83.10% and the Bank BPD Nusa Tenggara Barat Syariah (BPDNTBS) with a score of 80.60%. Meanwhile, the last three positions were held by the Bank Mega Syariah (BMS), the Bank Jabar Banten Syariah (BJBS), and the Bank Aceh Syariah (BAS), with respective values of 77.80%, 76.60%, and 69.80%.

By analysing these three indicators of Sharia compliance - Sharia investment, Sharia income, and profit sharing - studies can evaluate the financial performance of Islamic commercial banks. These ratios provide insights into the bank's adherence to Sharia principles, the proportion of income generated from Sharia-compliant activities, and the equitable distribution of profits. The assessment of these indicators can help stakeholders gauging the level of Sharia compliance and the bank's commitment to Islamic values in its operations.

Profitability of Islamic Commercial Banks. The profitability is a crucial aspect of the financial performance assessment among Islamic commercial banks. There are four key profitability indicators commonly used in order to evaluate their financial performance: The return on Assets (ROA), the return on Equity (ROE), the capital Adequacy Ratio (CAR), and the profit Margin. The following is the average value of the ratios of from years 2018–2022 (Table 3).

Table 3

Average Profitability of Islamic Commercial Banks from Years 2018–2022 (%)

Bank	ROA	ROE	CAR	Profit Margin	P
PT. Bank Aceh Syariah	2.15	20.77	19.06	17.11	14.77
PT. BPD Nusa Tenggara Barat Syariah	2.07	10.17	34.16	26.45	18.21
PT. Bank Muamalat Indonesia	0.05	0.97	13.32	1.91	4.06
PT. Bank Jabar Banten Syariah	0.52	1.82	18.51	1.56	5.60
PT. Bank Mega Syariah	1.19	6.04	21.55	7.74	9.13
PT. Bank Panin Dubai Syariah, Tbk	0.26	1.33	20.25	2.65	6.12
PT. Bank Syariah Bukopin	0.03	0.18	18.93	0.26	4.85

PT. BCA Syariah	1.17	4.03	35.97	10.41	12.90
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Source: Prepared by the authors (2023).

The Return on Assets (ROA) measures the efficiency of an Islamic bank in generating profits from its total assets. It indicates how effectively the bank utilises its assets to generate income. The Return on Equity measures the profitability of an Islamic bank to its shareholders' equity. It evaluates the bank's ability to generate returns for its shareholders' investments. The Capital Adequacy Ratio (CAR) measures how much capital is needed to support an Islamic bank's risk-weighted assets. It reveals the bank's capacity to withstand potential setbacks and preserve financial stability. The ability of an Islamic bank to turn a profit off of its revenue is used to gauge that bank's profitability.

For the Profitability indicator, as shown in the table above, the ROA ratio with the highest results was achieved by two banks, the Bank Aceh Syariah (BAS) and the the Regional Development Bank of West Nusa Tenggara Syariah (BPDNTBS), with values of 2.15% and 2.07%. In contrast, the lowest results were achieved by the Bank Syariah Bukopin (BSB) and the Bank Muamalat Indonesia (BMI), with values of 0.03% and 0.05%. The ROE ratio with the highest yield by the Bank Aceh Syariah (BAS) with a value of 20.77%, and the lowest result was achieved by the Bank Syariah Bukopin with a discount of 0.18%.

For the CAR ratio, the bank that obtained the highest yield was the West Nusa Tenggara Sharia Regional Development Bank (BPDNTBS), with a value of 34.16%, while the lowest output was from Bank Muamalat Indonesia (BMI) with a discount of 13.32%. For the Profit Margin ratio, the highest yield was obtained by the Regional Development Bank of West Nusa Tenggara Syariah (BPDNTBS) with a value of 26.45%. The lowest result was obtained by Bank Syariah Bukopin (BSB), with a value of 0.26%.

After adding up the four ratios above, the results show that the Regional Development Bank of West Nusa Tenggara Syariah (BNTBS) has the highest P indicator with a value of 18.21%. At the same time, the Bank Aceh Syariah is in second and third position) and the Bank Central Asia Syariah (BCAS) with a value of 14.77% and 12.90%. For the fourth position the Bank Mega Syariah (BMS) with a discount of 9.13%. The Bank Panin Dubai Syariah (BPDS) is in fifth position with a value of 6.12%. And the Bank Jabar Banten Syariah (BJBS), with a discount of 5.60%, is in sixth position, and seventh position by the Bank Syariah Bukopin (BSB), which obtains a value of 4.85%, and the Bank Muamalat Indonesia (BMI) is in the last class which receives a value 4.06%.

The Financial Performance Compare Between Islamic Banks That Have A High Level Of Sharia Compliance And Banks That Have A Low Level Of Sharia Compliance

These four profitability indicators provide valuable insights into the financial performance of Islamic commercial banks. They aid stakeholders in evaluating the bank's capacity to generate profits from its assets, shareholders' equity, and revenue, all while maintaining a robust capital position. Analysing these indicators aids in understanding the bank's overall profitability, efficiency, and financial sustainability (Table 4).

Table 4

Sharia Conformity and Profitability

Bank	SC	P
PT. Bank Aceh Syariah	69.8	14.77
PT. BPD Nusa Tenggara Barat Syariah	80.6	18.21
PT. Bank Muamalat Indonesia	83.1	4.06
PT. Bank Jabar Banten Syariah	76.6	5.6

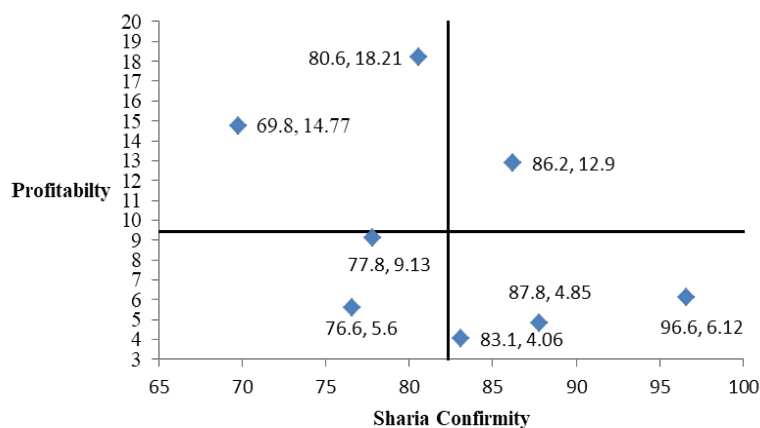
PT. Bank Mega Syariah	77.8	9.13
PT. Bank Panin Dubai Syariah, Tbk	96.6	6.12
PT. Bank Syariah Bukopin	87.8	4.85
PT. BCA Syariah	86.2	12.9

Source: Prepared by the authors.

The next step is to enter the SC and P indicator values obtained into the SCnP Model graph. The average value for the SC indicator coordinates is 82.31%, while the P indicator is 9.45%. The following diagram SCnP Model (Fig. 2):

Figure 2

SCnP Model



The diagram above shows that for the ULQ side, there are two banks, the West Nusa Tenggara Regional Development Bank and the Bank Aceh Syariah, which explains that the position of profitability is high, but the aspect of sharia conformity is low. On the URQ side, there is only one bank, the Bank Central Asia Syariah, which explains that the position of profitability is high and the aspect of sharia conformity is also high. On the LLQ side, there are two banks, the Bank Jabar Banten Syariah and the Bank Mega Syariah, which explains that the position of profitability and aspects of sharia conformity are low. Likewise, for the LRQ side, there are three banks, namely the Bank Muamalat Indonesia, the Bank Syariah Bukopin, and the Bank Panin Dubai Syariah, which explain the position of sharia confirmation is high, but the aspect of profitability is low.

In addition to discussing aspects of sharia conformity, aspects that also need to be addressed are aspects of assessing the soundness of a bank which is carried out at two points, namely earnings and capital. The data's source of profitability is Return on Assets (ROA). The value of ROA is obtained by first knowing the profit before tax and then dividing it by the average total assets. Meanwhile, the capital indicator is the Capital Adequacy Ratio provided to anticipate risks, known as CAR. The acquisition of each value can see in the Table 5.

Table 5

Earnings and Capital

Bank	ROA	CAR
BAS	2.15	19.06
BPDNTBS	2.07	34.16
BMI	0.05	13.32

BJBS	0.52	18.51
BMS	1.19	21.55
BPDS	0.26	20.25
BSB	0.03	18.93
BCAS	1.17	35.97

Source: Prepared by the authors.

The basis for the following assessment is a matrix for measuring the soundness of a bank from the ROA and CAR ratios as follows (Table 6, Table 7, Table 8).

Table 6

ROA Measurement Matrix

Rating	Description	Criteria	Composit Predicate
1	PK 1	> 1.45 %	Very healthy
2	PK 2	1.25% - 1.45%	Healthy
3	PK 3	0.99% - 1.25%	Healthy Enough
4	PK 4	0.75% - 0.95%	Unwell
5	PK 5	< 0.75%	Not healthy

Source: Attachment to SK DIR BI No 30/12/KEP/DIR.

Table 7

CAR Measurement Matrix

Rating	Description	Criteria	Composit Predicate
1	PK 1	CAR > 11 %	Very healthy
2	PK 2	9.5 ≤ CAR < 11%	Healthy
3	PK 3	8 ≤ CAR < 9.5%	Healthy Enough
4	PK 4	6.5 ≤ CAR < 8%	Unwell
5	PK 5	CAR < 6.5%	Not healthy

Source: Attachment to SK DIR BI No 30/12/KEP/DIR.

Table 8

ROA and CAR Composit Predicate

Bank	ROA	Composit Predicate	CAR	Composit Predicate
BAS	2.15	Very healthy	19.06	Very healthy
BPDNTBS	2.07	Very healthy	34.16	Very healthy
BMI	0.05	Not healthy	13.32	Very healthy
BJBS	0.52	Not healthy	18.51	Very healthy
BMS	1.19	Healthy Enough	21.55	Very healthy
BPDS	0.26	Not healthy	20.25	Very healthy

BSB	0.03	Not healthy	18.93	Very healthy
BCAS	1.17	Healthy Enough	35.97	Very healthy

Source: Prepared by the authors.

Based on the table above, we can see the results of the soundness level of Islamic commercial banks in Indonesia during the 2018–2022 period. For the ROA ratio, the conditions of the Bank Muamalat Indonesia, the Bank Jawa Barat Syariah, the Bank Panin Dubai Syariah, and the Bank Syariah Bukopin are at an unhealthy level because their ROA values are lower than the standard. As for the Bank Central Asia Syariah and the Bank Mega Syariah, they are in a reasonably healthy condition. Meanwhile, the Bank Aceh Syariah and the Regional Development Bank West Nusa Tenggara Syariah are titled Very Healthy. For the CAR ratio, eight sharia commercial banks have shown very satisfactory results where the predicate of all these banks are in very healthy condition.

Financial performance is a description of the financial condition of a company. Islamic banks are the object of research to measure their financial performance from 2018 to 2022. The Shariah Conformity and Profitability (SCnPP) model is an effective method for measuring how to achieve financial performance owned by Islamic commercial banks in Indonesia. The conformity of sharia provides an overview to the community and other parties related to the concept of Islam in the banking industry, which is a solution for Muslim communities to avoid practices prohibited in Islam. Even though it still adheres to these principles, it does not reduce the performance of Islamic banks in generating profitability to increase the progress of Islamic banks.

The financial performance of Islamic commercial banks in terms of the aspects of Islamic conformity and profitability shows results on the SCnPP model, divided into four quadrants in the period 2018 to 2022. The strategies or steps that can be carried out by Islamic commercial banks that occupy different quadrants in the SCnPP model.

For banks in the Upper Right Quadrant, which show high sharia conformity and high profitability, a stability strategy is the correct strategy to implement. This strategy requires banks to focus on pre-existing business lines that aim to maintain and continue to develop to achieve sustained competitive advantage.

For banks in the Lower Right Quadrant showing high sharia conformity but resulting in low profitability, the bank needs to reduce assets by closing facilities or reducing proper staff to reduce the company's operating budget.

For banks in the Upper Left Quadrant, which indicate high profitability but low Sharia conformity, this is attributed to the minimal profit sharing on Islamic bank products. Therefore, the strategy banks can implement in this position is to enhance the quality standards of DPS (Dewan Pengawas Syariah), which functions as an authority responsible for ensuring Sharia compliance within financial institutions, particularly Sharia banks.

As for banks that are located in the Lower Left Quadrant, which shows that the bank's financial performance has sharia conformity and low profitability, the strategy that can apply is a growth strategy, which means that the bank implements a growth strategy implemented by the company continuously such as company expansion which includes diversification or Other things.

Discussion

The Islamic banking sector in Indonesia has witnessed substantial growth in recent years, driven by the rising demand for Sharia-compliant financial products and the supportive regulatory framework for Islamic finance. Sharia compliance is a fundamental aspect of Islamic banking, guided by principles

derived from Islamic law (Sharia). In Indonesia, the Indonesian Council of Ulama (MUI) plays a key role in overseeing and providing guidance on Sharia compliance for Islamic financial institutions.

The regulatory framework governing Islamic banking in Indonesia is designed to ensure adherence to Sharia principles. Islamic banks and financial institutions to implement the Shariah principles and enhance the quality of Shariah compliance. Sharia compliance can easily draw the intention of the different stakeholders and fulfill their demands (Ayuso et al., 2014). Islamic banks are required to obtain Sharia compliance certification from the MUI, demonstrating their commitment to operating in accordance with the Islamic law. This certification process involves rigorous scrutiny of the bank's operations, products, and governance structures to ensure compliance with Sharia principles, such as the prohibition of interest (riba) and the promotion of risk-sharing and ethical investment practices.

The relationship between Sharia compliance and financial performance is a topic of significant interest and debate within the Islamic banking industry (Ben Abdallah & Bahloul, 2021). While some argue that adherence to Sharia principles may constrain profitability due to restrictions on certain financial activities, others contend that Sharia-compliant banking can lead to greater stability and long-term sustainability, ultimately enhancing financial performance (Alam & Islam, 2021). Empirical studies have shown mixed results regarding the impact of Sharia compliance on profitability (Nomran & Haron, 2020), Nathan (2010) highlighting the need for further research to better understand the dynamics at play.

Islamic banking, rooted in Sharia principles, places a strong emphasis on ethical and socially responsible financial practices. The level of Sharia compliance exhibited by Islamic banks significantly influences their financial performance and overall sustainability. This discussion aims to analyse and compare the financial performance of Islamic banks in Indonesia based on their adherence to Sharia principles.

High Sharia Compliance Banks

Islamic banks with high levels of Sharia compliance demonstrate a robust commitment to adhering to Islamic principles in all aspects of their operations. These banks meticulously ensure that their products and services comply with Sharia law, avoiding interest-based transactions (riba) and adhering to ethical investment practices. High Sharia compliance banks often undergo stringent scrutiny and certification processes from regulatory bodies or Sharia boards, ensuring the integrity of their operations.

Low Sharia Compliance Banks

Conversely, banks with low levels of Sharia compliance might demonstrate a less stringent commitment to Islamic principles or encounter obstacles in fully adopting Sharia-compliant practices. These banks may engage in activities that conflict with Sharia law, such as offering interest-based products or engaging in speculative transactions. Banks with low Sharia compliance may encounter reputational risks and regulatory scrutiny, potentially affecting their financial performance and long-term sustainability.

To compare the financial performance of high and low Sharia compliance banks, various metrics can be considered, including profitability ratios, asset quality indicators, and liquidity measures. Profitability ratios such as Return on Assets (ROA) and Return on Equity (ROE) provide insights into the banks' ability to generate profits from their assets and equity. Asset quality indicators, such as the Non-Performing Financing (NPF) ratio, assess the banks' credit risk management and asset quality. Liquidity measures, such as the Loan-to-Deposit Ratio (LDR) and Cash Reserve Ratio (CRR), evaluate the banks' ability to meet short-term obligations and manage liquidity risks.

Conclusions and Implications

This study aimed to examine and evaluate the financial performance of Islamic commercial banks in Indonesia in terms of their Islamic compliance and profitability for the period spanning 2018 to 2022. The study's findings highlighted the varying performance of Islamic commercial banks in Indonesia concerning Sharia compliance and profitability. It identified banks that exhibited high profitability and firm adherence to Sharia principles, which could serve as benchmarks for other banks to enhance their performance. Conversely, it identified banks facing challenges in either profitability or Sharia compliance, providing them with valuable insights for improvement and developing strategies to improve their financial performance while aligning with Islamic principles.

The limitation of this study employed the Sharia Compliance and Profitability Model to analyse the financial performance of the banks. While this model provided a framework for assessing Sharia compliance and profitability, it might have limitations in capturing the holistic performance evaluation of Islamic banks, as it focused specifically on these two dimensions. The study did not extensively consider external factors that could influence the financial performance of Islamic commercial banks, such as macroeconomic conditions, industry-specific dynamics, and regulatory environment. These factors might have significant implications for the banks' performance but were not explicitly accounted for in the analysis. As the study focused on Islamic commercial banks in Indonesia, the findings might not be directly applicable to Islamic banks in other countries or regions. The specific market conditions, regulatory frameworks, and banking practices in Indonesia could limit the generalisability of the study's findings.

Suggestions for Future Research

The findings of this comparison carry significant implications for stakeholders within the Islamic banking industry. Regulatory authorities may use the results to enforce stricter compliance standards and promote a culture of Sharia adherence among Islamic banks. Banks with low levels of Sharia compliance might need to reassess their business practices and implement measures to enhance compliance and improve financial performance. Moreover, investors and consumers can use the findings to make informed decisions regarding their banking relationships, favouring institutions with a strong commitment to Sharia principles.

Moving forward, it is essential for Islamic banks in Indonesia to continue prioritising Sharia compliance while also pursuing strategies to enhance their financial performance. This may involve investing in Sharia-compliant asset management, expanding outreach efforts to educate consumers about Islamic finance, and strengthening risk management frameworks to mitigate potential risks associated with Sharia-compliant activities. Additionally, a collaboration between industry stakeholders, including regulators, scholars, and practitioners, will be vital in tackling persistent challenges and nurturing sustainable growth within the Islamic banking sector.

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Conflict of Interest

None.

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