

Antecedents and Consequence of Murabaha Funding in Islamic Banks of Indonesia

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Abstract

As Islam supports fair trade, the *Murabaha* is the most popular and most common mode of Islamic financing. It is a contract of sale between the bank and its client for the sale of goods at a price plus an agreed profit margin for the bank. The contract involves the purchase of goods by the bank which then sells them to the client at an agreed mark-up. While their characteristics and values are unique, they are also subject to conventional measurement of efficacies. This study investigates how the primary health predictors of conventional banks under the Basel III regime could provide a positive means to assess the *Murabaha* funding and subsequently secure long-term profitability. This study constructed a path analysis (from 120 databases) to assess whether Islamic banks' leverage and capital adequacy may alter the *Murabaha* funding and increase stock equity directly and indirectly. The research findings are mixed where leverage does not alter the *Murabaha* funding but only affects the profitability; besides, capital adequacy increases the outgoing funding significantly but does not increase stock equity. *Murabaha* funding is essential to Islamic bank equity. This study implies *Murabaha* funding are expensed, despite increasing debts in Islamic banks.

Keywords: Islamic Banking, Murabaha, Leverage, Capital Adequacy, Equity

JEL Classification Code: G32, G31, G21

1. Introduction

Islamic banking, also referred to as Islamic finance or Shariah-compliant finance, refers to finance or banking activities that adhere to Shariah (Islamic law). The Islamic financial system has evolved as a viable and competitive component of the overall financial system as a driver of economic growth and development. The first

Islamic bank in the world was founded in 1963, and since then the phenomenon has grown slowly but steadily. In general, Islamic banks have performed as efficiently as conventional banks despite their self-imposed restriction (Ahmad & Haron, 2002). Islamic banking is currently a global phenomenon; Islamic banks are making their way into new markets where regulators are increasingly open to accommodate this finance model. The UK has become the first non-Muslim country to establish. Some researchers have examined this phenomenon by showing a positive role in shifting the country's economy for the better. Being a follower of Islam does not lead to becoming a customer of an Islamic bank. The emergence of the Islamic banking system has had a huge impact on the financial industry. The influential factors that are associated with Islamic banking adoption between the Muslim and non-Muslim population are innovativeness, compatibility, observability, complexity, perceived risk, perceived trust, customer innovativeness, and literacy (Said et al., 2019). The religiosity factor is also the main standard in patronizing Islamic Bank (Abduh & Omar, 2010).

The Islamic banking model is still in its infancy and many modifications and additions are required. It also lacks the necessary financial performance measurement tools

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similar to those used by conventional banks for managers and investors alike. Much of the previously measured performance of Islamic banks is unsound and should be revised for accuracy and reliability because of the flawed methods used for measurement in the first place. The absence of the interest system in Islamic banks is one of the critical factors in the differentiation of performance measurement methods. This study contributes by investigating the role of bad credit and capital adequacy in supporting the funding level, particularly Murabaha. In today's world, Murabaha has become the most popular financing technique amongst Islamic banks. The Islamic finance industry is still heavily reliant on Murabaha for liquidity management. About 90 percent of the total financing is concentrated on Murabaha, which is the result of existing institutional underpinnings (Bley & Kuehn, 2003). This overly large focus on funding has received various criticisms because it has a significant role in downplaying the bargaining position of Islamic finance by focusing only on one method, especially the knowledge aspect, that causes conventional finance to be more popular.

Islamic banks are more sensitive to risk, because of the various management systems and funding instruments options. Common stocks are a legitimate form of instrument in Islam, but many of the practices associated with stock trading are not. Speculation is not acceptable in Islam and measures would have to be taken to control speculative trading. Besides, short selling and margin trading are severely restricted. The use of the stock index and equity futures and options are also unlikely to be acceptable within an Islamic market. Regulatory authorities in Muslim countries will therefore find a vast array of problems in attempting to structure a trading system that will be acceptable (Naughton & Naughton, 2000). The scope of implementation and development of the sharia economy, which still leans towards the conventional financial sector, is also an obstacle to why sharia-based economies are so challenging to find a proper place. The challenges in implementing the sharia economy are also very complicated; an essential thing is because this economic system comes from Islam (Widarjono et al., 2020). Islamic banking is a banking system in accordance with the Shariat. In Islam, money has no intrinsic value – money, therefore, cannot be sold at a profit and is permitted to be used as per sharia principles only (Arfah et al., 2020).

A unique feature of Islamic banking, in theory, is its profit-and-loss sharing (PLS) paradigm. In practice, however, we find that Islamic banking is not very different from conventional banking. The rapid growth in Islamic banking is largely driven by the Islamic resurgence worldwide rather than by the advantages of the PLS paradigm and that Islamic banks should be subject to regulations similar to those of their western counterparts (Chong & Liu, 2009). Other academics have argued about the bad impact of interest on regional economic development (Zakir, 2009). Islamic

financial institutions often describe themselves as being providers of ethical financial services, although they do not spell it out explicitly. Islamic Banking is based on two main pillars; one is the economic Philosophy of Shariah and the second is the monetary theory of Islamic economics. Despite the substantial growth of Islamic banking in the last decade, there are some controversies and challenges which are prevailing about different concepts of Islamic banking and which need to be addressed (Wilson, 2002).

This study examines the issue of financial management of Islamic bank organizations as relying on several constructs. Islamic banking, based on the prohibition of interest, is well established throughout the Muslim world. Attention has now turned towards applying Islamic principles in equity markets. The first issue is the role of non-performing loans in channeling Murabaha funding in Islamic banks and its impact on bank equity (Naughton & Naughton, 2000). This issue will be compared with the role of capital adequacy in shaping the flow of organizational funds, as well as its role in organizational equity. This determination follows the Basel III framework as ratified by various countries in the world. The results of this study will provide an interesting contribution regarding the ability of Islamic banks to facilitate positive growth in organizational equity based on reviews of the bank's health and funding.

2. Literature Review

2.1. Stewardship Theory

Stewardship theory was coined by Donaldson and Davis (1991). Stewardship theory is a theory that managers, left on their own, will act as responsible stewards of the assets they control. Stewardship theorists assume that given a choice between self-serving behavior and pro-organizational behavior, a steward will place a higher value on cooperation than defection. Stewards are assumed to be collectivists, pro-organizational, and trustworthy (Davis et al., 1997). Stewardship theory is a framework that argues that people are intrinsically motivated to work for others or for organizations to accomplish the tasks and responsibilities with which they have been entrusted. It argues that people are collective minded and pro-organizational rather than individualistic and therefore work toward the attainment of organizational, group, or societal goals because doing so gives them a higher level of satisfaction. Stewardship theory, therefore, provides one framework for characterizing the motivations of managerial behavior in various types of organizations (Donaldson & Davis, 1991).

According to stewardship theory, steward behavior is collective. This is because stewards strive to achieve organizational goals, such as increasing sales growth or profitability (Davis et al., 2010). This behavior will further benefit the principal because their goals are then followed

up by the steward. The expert of this theory assumes that the relationship between principal and steward has a strong bonding in the organizational success. The stewardship behavior of managers results in exemplary corporate governance practices when the espoused values of the firm are aligned with the enacted values. Aligning the enacted values with the espoused value helps the firm to adapt itself to the changing external economic environment and continue creating shareholder value, the essence of corporate governance (Davis et al., 1997).

Given the phenomenal increase in Islamic banking activities globally, there must exist good governance practices of Islamic financial institutions. This is primarily to ensure its sustainability in the long run. More importantly, for Islamic banks to play an optimum role in the development of Islamic countries, it is imperative to develop regulatory structures that can help to control fraud, exploitation, and un-Islamic behavior in banking practices. Additionally, the development of strong governance practices will win public confidence, thereby promoting trust amongst equity holders, investors, and other parties dealing with these Islamic financial institutions. Stewardship theory is more applicable in Islamic banks rather than forming a governance structure based solely on the assumption that managers are self-serving and should be treated as agents (Sulaiman et al., 2015). Stewardship theory acts as the pre-eminent element in guiding directors in Islamic banks to monitor and trust their managers and encourage them to act as stewards and work for the best interest of their banks (Raharjo, 2007). An organization serves as a collective group behavior with higher utility than the individual and is always willing to serve (Pearson & Marler, 2010).

2.2. Signaling Theory

The Signaling theory was first introduced by Spence in 1973 who argued that companies should try to provide relevant information for people who need that information so that they can make the right decisions. Signaling theory is based on the assumption that information is not equally available to all parties at the same time, and that information asymmetry is the rule (Alós-Ferrer & Prat, 2012). Signal or sign is an action taken by firm management that guides investors about how management views the firm's prospects (Hopkins, 2012). Signaling theory suggests that companies with high quality should signal their advantages to the market. Signaling would make investors and other stakeholders reassess the value of the company, and then make decisions more favorable to the company (Abdullah et al., 2020; Wahab et al., 2020). The signaling theory is a behavior of corporate management in giving directions to investors, related to management strategies and views on future prospects. Disclosure of signaling theory is in the form of information (signals) of the success or failure

of a given company (Diamond, 1985). The application of signaling theory in this research is when Islamic banks provide information on financial reporting. The provision of this information is a signal for investors or customers to make appropriate decisions (Amin, 2013).

2.3. Leverage

Financing is the main income source activity in Islamic banks because by distributing the funds to customers they can get returns and margins for the provided funds. Bank credit risk can be communicated by the number of bad loans or non-performing loans (NPL) in conventional banks and Non-Performing Financing (NPF) in Islamic banks. The higher the value of NPL or NPF of the banks, implies the higher the credit risk of the bank. The rate of non-performing financing occurred is described by the non-performing financing (NPF) ratio. The nonperforming loan ratio, better known as the NPL ratio, is the ratio of the amount of nonperforming loans in a bank's loan portfolio to the total amount of outstanding loans the bank holds. The NPL ratio measures the effectiveness of a bank in receiving repayments on its loans. The lower the rate of NPF, the better the bank's health condition, the higher the NPF indicates a low bank health condition (Rodoni & Yaman, 2018; Widarjono et al., 2020). Small Islamic banks that are leveraged or based in countries with predominantly Muslim populations have lower credit risk than conventional banks. In terms of insolvency risk, small Islamic banks also appear more stable. There is little evidence that Islamic banks charge rents to their customers for offering Shari'a-compliant financial products. The loan quality of Islamic banks is less responsive to domestic interest rates compared to conventional banks (Abedifar et al., 2013). Several studies have analyzed the effect of funding decisions and risk to financing decisions on Islamic banks. The results showed NPF has a significant effect on all financing decisions (Rodoni & Yaman, 2018; Sutrisno, 2016; Muda & Afifah, 2018). Hence, it is expected that:

H1: Leverage affects the Murabaha funding negatively.

H2: Leverage affects the banks' equity negatively.

2.4. Capital Adequacy

Bank capital represents the value of a bank's equity instruments that can absorb losses and have the lowest priority in payments if the bank liquidates. Capital is a key ingredient for safe and sound banks. The capital owned by a bank is a requirement to offset all business risks. Capital Adequacy Ratio (CAR) is the ratio of a bank's capital in relation to its risk-weighted assets and current liabilities. It is decided by central banks and bank regulators to prevent banks from taking excess leverage and becoming insolvent in the process (Usman & Lestari, 2019). The amount of

CAR will certainly support the operational development and survival of the financial institution and increase the ability of the bank to earn profits. The CAR was introduced with the objective to protect the bank depositors by promoting stability and efficiency in the banking systems.

Therefore, Bank Indonesia (BI) as the central bank of the Republic of Indonesia (RI) has regulated the CAR for each financial institution. As in regulation number 10/15/PBI/2008 article 2 paragraph 1, it is stated that banks are required to provide a minimum capital of 8% of their Risk-Weighted Assets (RWA). It helps the banks to maintain capital based on the riskiness of each loan exposure. For instance, two banks with the same loan book size but a different level of portfolio risk will be required to maintain corresponding bank capital. Higher the risk, the higher the capital required. The ratio is a good indicator for the investors to understand the overall risk of the loan book of a bank. (Usman & Lestari, 2019). Previous researches support that the CAR affects Murabaha funding (Almazari, 2013). Changes in the bank's capital are negatively associated with the changes in risk in a significant way, thus implying that increasing capital ratio would be effective in reducing portfolio risk with the implementation of regulation governing the capital adequacy of commercial banks (Zhang et al., 2008). CAR is also found to reduce the risk profiles of the bank significantly supporting the importance of high CAR to decrease the bank aggressiveness in financing *Murabaha* account (Husaeni, 2017), and as such:

H3: *Capital adequacy serves as the foundation of Murabaha funding.*

H4: *Capital adequacy also increases the equity of the Islamic banks.*

2.5. Murabaha Funding

Bai 'al-Murabaha is the Islamic term for the sale and purchase of goods at the original price with an agreed additional profit. Murabaha, also referred to as cost-plus financing, is an Islamic financing structure in which the seller and buyer agree to the cost and markup of an asset. The markup takes place of interest, which is illegal in Islamic law (Khan, 2011). The Murabaha form of financing is being widely used by Islamic banks to satisfy various kinds of financing requirements. It is used to provide finance in various and diverse sectors e. g. in consumer finance for the purchase of consumer durable such as cars and household appliances, in real estate to provide housing finance, in the production sector to finance the purchase of machinery, equipment, and raw material, etc. However, probably the most common and the most popular application of Murabaha is in financing the short-term trade for which it is eminently suitable (Rodoni & Yaman, 2018). Originally, Murabaha was a contract of sale in which a commodity is sold on profit. The seller is obliged to tell the buyer his cost price and the profit he is making.

This contract has been modified a little for application in the financial sector. In its modern form, Murabaha has become the single most popular technique of financing amongst Islamic banks (Miah & Suzuki, 2020). The Profit-sharing and losses sharing (PLS) contract differentiates the Islamic financing and its conventional banking counterpart. The PLS refers to the so-called participatory transactions in the financial world mostly through the concept of Mudharabah (profit sharing) and Musharakah (joint venture). Apart from the PLS concept, the non-PLS concept is also allowed in Islam. This includes the debt-based contract such as Murabaha.

Murabaha is favored by Islamic banks for its easiness and safer risk profile, comparable to the PLS that necessitate Islamic banks to also take part in the possible incurred loss of their business partners. It applies return sharing instead of PLS, meaning all incomes are constructed to pay the associated burden to the Islamic banks (Miah & Suzuki, 2020). Thus, the contracts under the PLS system are in line with the reasoning of Islamic legal jurisprudence instead of return-based sharing (Mergaliyev et al., 2019). Empirical evidence reveals that Murabaha funding positively supports the increase in the Islamic banks' return on equity (Alkhazaleh & Al-Dwiry, 2018; Kuswara et al., 2019); however, another study discovered a negative relationship (Effendi, 2020), and other study finds it to be insignificant (Alzoubi, 2017; Rosiana et al., 2019), and thus:

H5: *Murabaha funding increase Islamic bank equity.*

H6: *The leverage indirectly affects the Islamic bank equity by Murabaha funding indirectly.*

H7: *The capital adequacy affects the Islamic bank equity by Murabaha funding indirectly.*

3. Research Methods and Materials

This study obtained the data from the site of Islamic banks in Indonesia in 2013–2018 using purposive sampling. Purposive sampling is an acceptable kind of sampling for special situations. It uses the judgment of an expert in selecting cases or it selects cases with a specific purpose in mind. The following criteria have to be considered i.e., semester financial reports published comprehensively by the Islamic Commercial Banks. The published financial reports are for the 2013–2018 period. Based on the sample selection process, 10 firms serve as the database to observe the movement of each relationship. Thus, the total number of samples obtained is 120 data. For the purpose of the study, the data analysis operationalized the following financial ratios:

Leverage as measured by non-performing finance:

$$\text{NPF} = \frac{\text{total NPF}}{\text{total financing}} \times 100\% \quad (1)$$

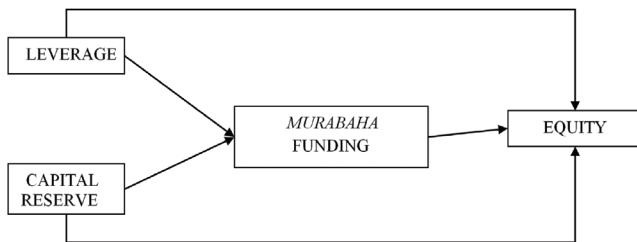


Figure 1: Conceptual Framework

Capital reserves as measured by a capital adequacy ratio (CAR)

$$CAR = \frac{\text{capital}}{\text{RWA}} \times 100\% \quad (2)$$

Equity is measured by return on equity (ROE)

$$ROE = \frac{\text{net income}}{\text{equity income}} \times 100\% \quad (3)$$

This study collects the Murabaha funding as the amount of transaction under the fund account, and transform them by the natural logarithm to make the spread between ratio analysis and the nominal scale funding closer. As such, this study proposes the following conceptual model:

This study regressed the proposed path analysis by employing statistical tools of SmartPLS 3 to run Partial-Least-Square Structural-Equation-Modelling (PLS-SEM). The PLS-SEM is used to estimate complex cause-effect relationship models with latent variables. To ensure the representativeness of the regression result, classical assumption tests are performed. The inferential statistics tests are then interpreted in the discussion section.

4. Results and Discussion

Table 1 compiles the descriptive tests of the study. It can be seen that the NPF ranges from 0.04% (minimum) to 6.4% (maximum) with a mean of 1.7% indicating highly dispersed data in the study. CAR ranges from 10% (minimum) to 60% (minimum) with a mean of 20%, revealing the strong tendency of Islamic banks to maintain their capital in compliance with the Basel Accord as well as the Central Bank regulation. The Murabaha account dominates the Islamic bank business with a mean of 15.29, while the ROE fluctuates from a negative value (minimum profitability) of –94% to a positive value (maximum profitability) of 50.3%.

Table 1 provides interesting information on the descriptive data. The NPF in Islamic banks has increased

from 0.4% to 6.4%. This condition indicates an increase in problematic debts in Islamic banks. The highest percentage of NPF was 6.4%, which shows a fairly high yield compared to Indonesia's Central Bank's standard. However, there is a very large build-up of capital reserves in Islamic banks, with a maximum of 61%. This fact shows that Islamic banks are not sharp enough to carry out intermediation efforts, with this large idle fund. The fear of taking out a loan because of a high enough non-performing loan rate allows this condition to happen. *Murabaha* funding as the favorite instrument of Islamic banks also shows the phenomenon of the magnitude of numbers that dominates the bank's funding portfolio. Finally, the income/equity data shows various results, from minus to 50%. This condition shows the different business management capabilities of each bank.

Before conducting an inferential test, this study investigated the capability of the data to meet the classical assumption as well as PLS-SEM requirements. The Kolmogorov-Smirnov test is used to decide if a sample comes from a population with a specific distribution, that is, it is commonly used as a test for normality to see if your data is normally distributed. The finding indicates the usability of the data meets the normality test of Kolmogorov Smirnov which is 0.077, as well as a probability plot displaying linear data along the straight line.

Variance inflation factor (VIF) is a measure of the amount of multicollinearity in a set of multiple regression variables. Values of VIF that exceed 10 are often regarded as indicating multicollinearity, but in weaker models values above 2.5 may be a cause for concern. The VIF to measure multicollinearity ranges between 1 and 2 indicating the absence of multicollinearity. Multicollinearity is a problem in regression analysis that occurs when two independent variables are highly correlated. The relationship between the independent variables and the dependent variables is distorted by the very strong relationship between the independent variables, leading to the likelihood that our interpretation of relationships will be incorrect.

If there is a particular pattern in the SPSS Scatterplot Graph, such as the points that form a regular pattern, it can be concluded that there has been a problem of heteroscedasticity. Conversely, if there is no clear pattern, and spreading dots, then the indication is no heteroscedasticity problem. The scatter plot test also reveals a random position of each data, signifying the no heteroskedasticity in the data.

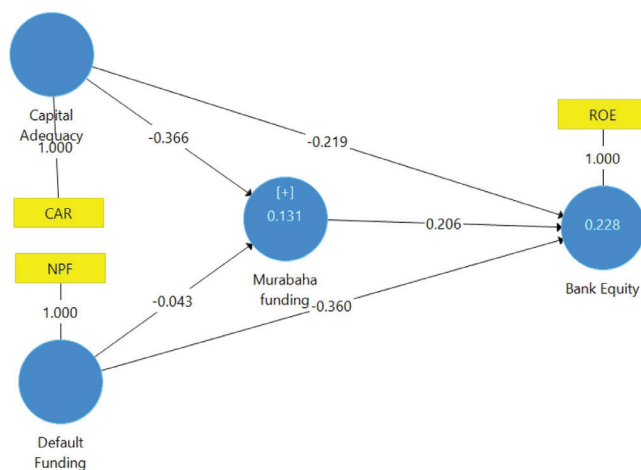
The Durbin Watson Test is a measure of autocorrelation. The Durbin-Watson statistic will always have a value between 0 and 4. Values from 0 to less than 2 indicate positive autocorrelation and values from 2 to 4 indicate negative autocorrelation. The Durbin Watson's test score of 1.924, indicates the absence of autocorrelation and potential problems from time-series data.

Table 1: Descriptive Measures

Variable	N	Minimum	Maximum	Mean	Std. Deviation
NPF	120	0.004	0.0644	0.027	0.017
CAR	120	0.107	0.61	0.20	0.093
Murabaha funds (ln)	120	12.4	17.98	15.29	1.41
ROE	120	-0.94	0.503	0.042	0.164
Valid N	120				

Table 2: The Summary of the Path Analysis

Relationships	Effect Size	t-value	p-values	Hypothesis
NPF → <i>Murabaha</i>	-0.043	0.502	0.616	H1 rejected
NPF → ROE	-0.360	6.386	0.000	H2 accepted
CAR → <i>Murabaha</i>	-0.366	5.939	0.000	H3 accepted
CAR → ROE	-0.219	1.763	0.078	H4 rejected
<i>Murabaha</i> → ROE	0.205	3.458	0.001	H5 accepted
NPF → <i>Murabaha</i> → ROE	-0.009	0.493	0.622	H6 rejected
CAR → <i>Murabaha</i> → ROE	-0.075	3.134	0.002	H7 Accepted
R^2 to <i>Murabaha</i> funding = 0.131				
R^2 to Bank Equity = 0.228				

**Figure 2:** Path Coefficient

This study employs a single measure for each construct, making all the data to be standardized in PLS-SEM, and serve normally to meet the outer model measurement criteria such as convergent validity, discriminant validity, or collinearity tests. As the classical tests and PLS-SEM report substantial support for the investigation, this study could perform the data analysis, and summarize the finding in Table 2.

Table 2 summarized the various results from the formulation of this study. The results obtained are quite diverse where debt is not a reason for Islamic banks to loosen their financing level, as the results are not significant, which shows the rejection of hypothesis 1 with a t -value of 0.502. In contrast, statistical analysis shows that the debt ratio can negatively affect the equity level of Islamic banks with a t -value of 6.386 which shows acceptance of hypothesis 2. Islamic banks are more concerned about their main capital availability, which is summarized in CAR with a t -value of 5.939, and shows acceptance of hypothesis 3 while the CAR has no impact on the equity level, which indicates rejection of hypothesis 4. The level of *Murabaha* funding is one of the important predictors of Islamic bank equity and hence the acceptance of hypothesis 5. The indirect test varies, that is the rejection of hypothesis 6 and acceptance of hypothesis 7, as well as confirming the partial mediation relationship in this study. A summary of the effect magnitude of each variable can be seen in Figure 2.

Based on the research results obtained from the path analysis, it shows that the non-performing financing (NPF) variable has a positive and insignificant effect on *Murabaha* funding. It means that NPF does not affect *Murabaha* funding in Islamic banks. This is due to the high demand and financing as well as the handling of NPF.

This is proven in the Sharia Banking Statistics (SPS) data for the 2013–2018 period, where the NPF for Islamic banks is lower than 5% wherein Bank Indonesia maintains a maximum NPF standard of 5%. Currently, Islamic banks in Indonesia have established a strategy in providing financing to prospective customers so that the level of NPF can be reduced. Therefore, before Islamic banks distribute finance, they will further analyze the customer's ability to repay the finance (Sulaiman et al., 2015). The distribution of finance by Islamic banks is a profit-generating activity, considering that financing is a high income for Islamic banks. But on the other hand, it has a high risk, therefore as an effort to overcome the high NPF, Islamic banks are intensely analyzing a finance application to minimize the risks in financing (Widarjono et al., 2020).

Based on the research results obtained from the path analysis, it shows that the NPF variable has a negative and significant effect on ROE. This means that NPF has a unidirectional relationship. In other words, when NPF increases, ROE decreases. On the contrary, when NPF decreases, it will increase the ROE of the bank. The results of this study are in accordance with the theory that any increase in NPF decreases profitability. This happens because when NPF increases, banks must be prepared to bear losses on the expenses borne by them, both operating and non-operating expenses, such that the profitability will decrease. The NPF percentage has also been determined by Bank Indonesia at 5%. Therefore, banks must be careful in financing customers. When Islamic banks in Indonesia have a high level of NPF, the level of profitability will decrease (Rosiana et al., 2019).

CAR variable has a negative and significant effect on Murabaha funding. This indicates that each increase in CAR causes a decrease in Murabaha funding. Capital acts as a financial cushion against losses. When, for example, many borrowers are suddenly unable to pay back their loans, or some of the bank's investments fall in value, the bank will make a loss and without capital, cushion might even go bankrupt. However, if it has a solid capital base, it will use it to absorb the loss and continue to operate and serve its customers. That is, CAR is the ratio of a bank's capital in relation to its risk-weighted assets and current liabilities. The results of this study are not in line with the previously established theory, where CAR has a positive effect on Murabaha funding. Currently, Islamic banks focus their attention on managing the risks from assets. Hence, Islamic banks focus on allocating financial resources (capital) to protect potentially risky assets (Almazari, 2013). Islamic banks do not provide high-risk finance as it will add to risky assets such that it requires the banks to increase their capital to meet the CAR.

The CAR variable has a positive and insignificant effect on ROE. This means that the CAR variable has no effect on

ROE in Islamic banks. In other words, if the CAR increases, it does not lead increase in ROE. ROE signifies how good the company is in generating returns on the investment it received from its shareholders. The higher the CAR, the higher the ROE value. This is because if a bank has a high CAR, it means that the bank has a lot of capital to carry out its operational activities and is able to bear the risk if the bank is liquidated. Banks that have high CAR but do not use their capital effectively to generate profits, in such case, CAR will not have a significant effect on ROE (Usman & Lestari, 2019). The results of this study are not in line with the previously established theory, where CAR has a positive effect on ROE. A high CAR indicates that the bank has high capital adequacy. However, the results of this study indicate that a high CAR does not affect the ROE of Islamic banks. This is because of the Bank Indonesia regulation which requires Islamic banks to have at least 8% as the CAR ratio. Both minimum and additional capital requirements are binding and there are legal consequences if they are not adhered to (Husaeni, 2017).

The Murabaha funding variable has a positive and significant effect on ROE. This is because financing is a source of income for banks. As such, if the channeled financing (Murabaha) increases, it increases the profits level in the form of returns and the margin obtained by Islamic banks. The results of this study are in accordance with the developed theory where Murabaha funding has a positive effect on bank profitability. Murabaha funding is one of the most popular products for customers, making it the most popular financing product in the Islamic banking industry in Indonesia (Effendi, 2020). Financing is also one of the largest asset-building components in Islamic banks and will generate income in the form of margins. This margin will affect the amount of profit earned, increasing the profitability of Islamic banks. Thus, it can be said that financing with Murabaha is one of the essential components for increasing the profitability of Islamic banks (Alzoubi, 2017).

Murabaha funding as an intervening variable in this study cannot mediate the effect of the NPF variable on ROE. The amount of NPF level at Islamic banks will reduce the opportunity for Islamic banks to gain profit. Hence, if the NPF is high, the level of profitability will decrease. As a result of declining liquidity and the adverse condition of macroeconomics, most of the funds that are channeled by Islamic banks to the public are not repaid leading to loan default. Such defaulted loans are known as NPF because the given loans no longer "perform" and are classified as substandard or doubtful assets (Almazari, 2013; Alzoubi, 2017; Rosiana et al., 2019). Besides, the financial risk can also occur due to bank negligence and mistakes made while providing funds to the public.

Murabaha funding as an intervening variable in this study that mediates the effect of the CAR variable on profitability. A high CAR indicates that a bank has high capital adequacy. CARs mandate that a certain amount of the deposits be kept aside whenever a loan is being made. These deposits are kept aside as provisions to cover up the losses in case the loan goes bad. These provisions, therefore, limit the amount of deposits that can be loaned out and hence limit the creation of credit. Changes to the CAR therefore can have a significant impact on inflation in the economy. Capital acts as a financial cushion against losses. When, for example, many borrowers are suddenly unable to pay back their loans, or some of the bank's investments fall in value, the bank will make a loss and without capital, cushion might even go bankrupt (Almazari, 2013; Alzoubi, 2017). So that by absorbing the loss, the bank's business activities will not in potential loss. However, on the other hand, a bank that has high capital adequacy but does not use its capital effectively to generate profits will not have a significant effect on profitability.

5. Conclusion

The results of this study show various results. Murabaha has become the most popular financing technique amongst Islamic banks. 90 percent of financial operations are made by using this technique. The interaction between this type of financing and various contexts shows that the NPF level does not stop the aggressiveness of this financing. On the other hand, a high level of capital adequacy significantly reduces the level of Murabaha funding. The NPF level is the concern of shareholders, based on research findings, meanwhile, however, they are not much concerned about the capital adequacy level. This study also found the absence of the role of Murabaha funding as a mediation between exogenous and endogenous variables in this study. This research is certainly still far from perfect because the data collected is relatively small. Therefore, future research could obtain broader information based on additional appropriate data. Comparisons between Islamic and conventional banks will also provide valuable information and can be a formula in strategic policymaking for organizations, as well as Indonesian financial governance.

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