

# Equity Based Financing Volume:

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## Determinant of the Equity Based Financing Volume: A Case of Islamic Banks in Indonesia

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### Abstract

The aim of this research is to examine the influence of Third Party Funds, Profitability (Return on Assets), Risk (Non Performing Finance) and Cost Efficiency (Operational Cost Efficiency Ratio) on Equity Based Financing Volume of Islamic banks in Indonesia. The research population was Islamic banks registered in the Central Bank of Indonesia (BI). Chosen by using purposive sampling method, this research used 13 banks as sample. This study used multiple regression analysis as the method. The result of this research indicates that: (1) Third Party Funds has positive effect on Equity Based Financing Volume; (2) Profitability has no influence on Equity Based Financing Volume; (3) Risk has no significant influence on Equity Based Financing Volume; (4) Cost Efficiency has positive effect on Equity Based Financing Volume.

**Keywords:** Third Party Fund, Return on Assets, Non Performing Finance, Operational Cost Efficiency Ratio, Equity Based Financing Volume

### 1. Introduction

According to the statistics of Islamic Bank published by the Central Bank of Indonesia- in September 2013- the number of Islamic commercial banks had reached a figure of 11 banks with total number of 1,937 of offices branches available across nation. Meanwhile the numbers of Islamic banking units available are 23 units with a total amount of offices branches are 558. Significant growth is also evidenced in the number of Islamic Rural Banks operating in Indonesia which is amounted to 160 banks with 413 branch offices exist around (Islamic banking statistic Bank Indonesia, 2013).

Despite of its increasing popularity, the total share of Islamic banks in the market is only amounted to below five percent- although growing nominal amount is evidenced- within the whole banking industries. The number of third party funds increased from Rp 115,415 billion in 2011 to Rp 171,701 billion in September 2013. The total amount of profit generated by Islamic banks have increased from 2,037 billion dollar in 2011 to 3,248 billion dollar in 2013. However of the total 177,320 billion IDR financing volume in September 2013 only 13,364 was distributed in the form of *Mudharaba* and 36,715 billion IDR was in the form of *Musyaraka*. If compared to the amount of *murabahah* financing - 106,779 billion IDR- the portion of equity based financing is much smaller (7.53 percent for *Mudharabah* and 20.7 percent for *musyarakah*) while *murabaha* is 60.2 percent. The profit sharing principle is the main characteristic of Islamic banking (Antonio, 2001:137) as a result the profit sharing mode of financing should share greater proportion as compared to the non-profit sharing of financing in Islamic bank.

Dar and Persley (2001) have successfully identified seven factors that cause the imbalance of profit and loss sharing (PLS) financing control that resulted in less schemes on profit sharing in Islamic banking practices in world. First, PLS contracts are inherently vulnerable to agency problems as entrepreneurs have disincentives to put in effort and have incentives to report less profit as compared to the self-financing owner-manager; second, PLS contracts require well-defined property rights to function efficiently. Third, Islamic banks and investment companies have to offer relatively less risky modes of financing as compared to *Mudharaba* or *Musharaka* in the wake of severe competition from conventional banks and other financial institutions, which are already established and hence more competitive. Fourth, the restrictive role of shareholders (investors) in management and, hence, the dichotomous financial structure of PLS contracts make them non-participatory in nature, which allows a sleeping partnership. Fifth, equity financing is not feasible for funding short-term projects due to the ensuing high degree of risk (i.e., the time diversification effect of equity). Sixth, unfair treatment in taxation is also considered to be a major obstacle in the use of PLS. Seventh, secondary markets for trading in Islamic financial instruments, particularly *Mudharaba* and *Musharaka*, are non-existent. Similar findings were also proposed by other researchers such as Kahf and Khan (1992); Ahmad (1993); Errico and Farahbarksh (1998).

Lack of equity based or profit and loss sharing financing phenomena around the world may result in the negative public perception on Islamic banking. For example Khan et al (2011) compared the performance of conventional banks and Islamic banks in Pakistan in 2006-2009, and concluded that Islamic banks are less efficient in terms of its profitability and income levels as compared to the conventional banks in Pakistan. Some countries, with establish Islamic economic system, such as Sudan has imposed a maximum amount of *murabahah* financing to 30 percent to encourage profit and loss sharing financing, *mudharabah* and *musyarakah* (Ascarya and

Yumanita, 2005).

Problems arise when high growing rates industry's assets are not equally compensated by company's profits. Islamic banks' cost efficiency provide severe impacts on the amount of profit generated by Islamic banks, which makes the level of ROA in Islamic banks lower as compared to that of the conventional banks.

Operating side by side with conventional banks, Islamic banks are not spared but equally vulnerable to risks. The exception is that the nature of risks facing Islamic banking is unique. This uniqueness arises from the composition of its assets and liabilities (Ahmad and Ahmad, 2004)

One of ways of asset management is by creating credit products, the amount of credit granted to the public will affect the amount of profits that will be collected by the bank, because the main purpose of credit is to make a profit (Kasmir, 2003). The number of Bank's Non Performing Finance (NPF) and bank cost efficiency are also important indicators of banks' operating performance, which is tied up to Islamic banks' product development, in the case of Islamic banking is the equity based (profit sharing) financing.

Therefore, determining factors influencing equity based financing volume is necessary in order to assist Islamic bank in maintaining their role in the industry through increasing the volume of equity financing. To this end, an inquiry is needed to study those determinants for the sake of Islamic banking credibility, especially in Indonesia.

## 2.1 Problem Statement

Based on the background of the research above, the following research questions arise:

1. Does Third-party Funds influence the equity based (profit sharing) financing volume?
2. Does Profitability influence the equity based (profit sharing) financing volume?
3. Does Risk influence the equity based (profit sharing) financing volume?
4. Does Cost Efficiency influence the equity based (profit sharing) financing volume?

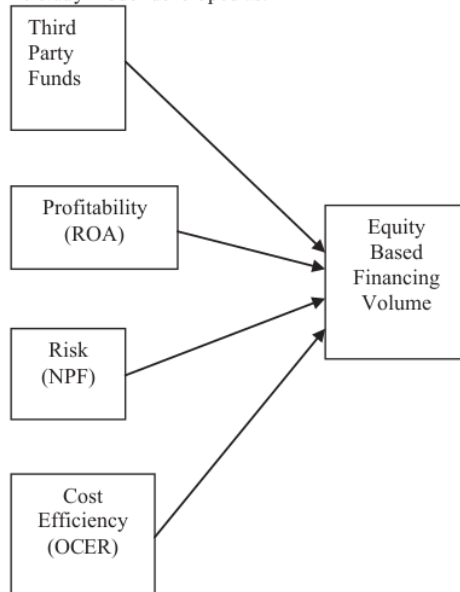
## 1.2 Aims of the Research

This research aims are:

1. To analyze the influence of Third-party Funds on the equity based financing volume.
2. To analyze the influence of Profitability on the equity based financing volume.
3. To analyze the influence of Risk on the equity based financing volume.
4. To analyze the influence of Cost Efficiency on the equity based financing volume.

## 1.3 Research Model

The study model developed as:



#### 1.4 Hypotheses

- H<sub>1</sub>: Third Party Funds (TPF) has a positive influence on Equity Based Financing Volume.
- H<sub>2</sub>: Profitability (Return on Assets) has positive influence on Equity Based Financing Volume.
- H<sub>3</sub>: Risk (Non Performing Financing) has a negative influence on Equity Based Financing Volume.
- H<sub>4</sub>: Cost Efficiency (Operational Cost Efficiency Ratio) has positive influence on Equity Based Financing Volume.

## 2. Research Method and Techniques of Data Analysis

### 2.1 Research Type

This research is a quantitative research encompasses a formal, objective, systematic process in which numerical data are used to obtain information about the world (Burns and Grove, 2005) and a predictive study whereby data is derived from information about the past or present to estimate the situation that may occur in the future (Cooper and Schindler, 2007). All of the data were obtained from financial reports published by Bank Indonesia which is accessible from [www.bi.go.id](http://www.bi.go.id).

### 2.2 Population and Sample

The population of the research is the Islamic banks registered at Bank of Indonesia (BI). It consists of 3 types of Islamic Bank, which are Islamic commercial bank (Bank Umum Syariah), Islamic banking unit (Unit Pembiayaan Syariah), and Islamic rural bank (Bank Pembiayaan Rakyat Syariah). The total amounts of Islamic banks listed are 191 banks. The sample of this research was chosen by using purposive sampling method with the following criteria:

- a. Islamic commercial banks and Islamic banking units listed on the Bank of Indonesia during the period of 2009-2012.
- b. The banks had published financial reports during the research period 2009-2012.
- c. The Financial statements chosen are reported yearly.

Based on the criteria mentioned earlier, the numbers of sample obtained were 13 units.

### 2.3 Operational Definition

#### I. The equity based financing volume in Islamic banks (Y).

Equity based financing are those mode of financing share its return based on profit sharing or revenue sharing. Profit sharing is based on the contract made by *shahibul maal* and *mudharib* at the beginning of the business agreement which is called *akad*. In this study the data is taken from the condensed balance sheet published by Bank of Indonesia on the left side under the assets column. The data is represent in million IDR unit

#### II. Third Party Funds (X1)

Third Party Funds are funds in the form of deposits from the public. The funds collected from the community is the largest funding source most relied upon by the bank (can reach 80 to 90 percent of all funds managed by the bank) (Dendawijaya, 2005:47). It can be calculated as :

Third Party Fund = Demand deposit + time deposit + Saving

#### III. Profitability (Return on Assests) (X2)

Return on Asset (ROA) is an indicator of how profitable a company is relative to its total assets. ROA gives an idea as to how efficient management is at using its assets to generate earnings. Calculated by dividing a company's annual earnings by its total assets, ROA is displayed as a percentage. Sometimes this is referred to as "return on investment". ROA shows company's ability in doing the efficiency of use of the total assets for the company's operations, the value of a high ROA showed the efficiency of asset management, it can be said that the efficiency of management in creating enterprise (Hanafi and Halim, 2007). The formula for return on assets is:

$$ROA = \frac{\text{Net Income}}{\text{Total Assets}}$$

#### IV. Risk (Non Performing Finance) (X3)

Non performing finance (NPF) is a productive asset with asset quality- substandard, doubtful, and loss- that damage the credit risk is any risk associated with the possible failure of the client to pay its obligations or the risk that the debtor can not repay their debts (Ghozali 2007). NPF calculation is:

$$\text{NPF ratio} = \frac{\text{Non-performing-financing}}{\text{Total Financing}}$$

#### V. Cost efficiency (OCER) (X4)

OCER is used to measure the level of efficiency and the ability of banks to carry out operations, calculated by comparing the amount of operating expenses and operating income. Healthy bank OCER ratio is less than 1

otherwise unhealthy bank OCER ratio is greater than 1. OCER Formulation:

$$\text{OCER} = \frac{\text{Operational Expenditure}}{\text{Operational Income}}$$

## 2.4 Techniques of Data Analysis

The analysis technique used in this research was quantitative analysis. The data analysis method of this research was multiple linear with *double-log* model regressions and time series data to obtain the whole description about the influence of variable Third Party Funds, Profitability (ROA), Risk (NPF), and Cost Efficiency (OCER) on Equity Based Financing Volume using SPSS program. Double log model or constant elasticity models, namely the transformation performed on both the dependent variable and independent variables (Nachrowi and Hardius, 2006: 65). The regression equation can be formulated as follow:

$$\text{LnY} = a + b_1\text{LnX}_1 + b_2\text{LnX}_2 + b_3\text{LnX}_3 + b_4\text{LnX}_4 + e$$

## 3. Result and Analysis Data

### 3.1 Classical Assumption Test

#### I. Normality Test

To determine data using Kolmogorov-Smirnov test, the significance value should be above 0,05 or 5% (Imam Ghazali, 2005). The significance value is 0.515, which is above 0.05, it means that the data are distributed normally.

#### II. Multicollinearity Test

Table 2. Multicollinearity Test Result

No	Variable	Collinearity Statistics	
		Tolerance	VIF
1	Third Party Fund	0.648	1.543
2	Return on Assets	0.508	1.968
3	Non Performing Financing	0.861	1.162
4	Operational Cost Efficiency Ratio	0.402	2.488

A regression model is stated to be free from multicollinearity if it has tolerance value above 0,1and VIF below 10. From the table above, the tolerance value of all independent variables was above 0,1and VIF far below 10. Thus, there is no multicollinearity problem in this model.

#### III. Heteroscedasticity Test

Table 3. Heteroscedasticity Test Result

Independent variables	t	Sig.
Third Party Fund	1.963	0.056
Return on Assets	1.776	0.082
Non Performing Financing	-0.894	0.376
Operational Cost Efficiency Ratio	-1.361	0.180

As clearly seen from Table 3, all dependent variables were *absolute residual* from each regression equation. It can be seen from the significance level of each independent variable examined, where the significance level of each independent was more than 5%. Thus, it could be concluded that there was no heteroscedasticity in each regression equation employed in this research.

#### IV. Autocorrelation Test

The value of *assump.sig* is 0.086 which is above alpha 0.05 which leads to a conclusion that the autocorrelation assumption is not violated.

### 3.2 Multiple Regression Analysis

Table 5. The Result of Regression Calculation

	Coefficient	t <sub>statistic</sub>	Probability
Constant	0.433	0.173	0.864
TPF	0.474	2.601	0.013
ROA	-0.239	-0.849	0.401
NPF	0.277	1.513	0.137
OCER	1.198	2.021	0.049
Adjusted R <sup>2</sup> = 0.480		F <sub>statistic</sub> = 12,306	

Based on the table above, the equation of the multiple linear regression can be formulated as follows:

$$\text{LnY} = 0.433 + 0.333\text{LnX}_1 - 0.123\text{LnX}_2 + 0.168\text{LnX}_3 + 0.328\text{LnX}_4$$



### 3.3 Statistical Test Model

#### a. Coefficient Determination Test

This test was used to prove the extent of effect of independent variable could clarify the dependent variable. Based on the statistical calculation, the obtained value of determination coefficient was 0.480 or 48 percent. Third party fund, return on assets, non performing financing, and operational cost efficiency ratio contribute 48 percent to equity based financing volume, which was considered quite high contribution. The remaining 52% was affected by the variables which were not included in this research.

#### b. Test of Simultaneous Significance

F test was used to examine the influence of independent variables jointly on the dependent variable. Based on the calculation with the confidence level 95% or significance level ( $\alpha$ ) = 0.05, it was known that the value of  $F_{\text{statistic}}$  was 12.306, while the value of  $F_{\text{table}}$  was 2.570. The value of  $F_{\text{statistic}}$  is greater than the value of  $F_{\text{table}}$  or at the denial area  $H_0$ . Thus, it could be concluded that third party fund, return on assets, non performing financing and operational cost efficiency ratio simultaneously had significant influence on equity based financing volume.

#### c. Evaluating Each of The Independent Variables

The value of  $t_{\text{statistic}}$  of variable TPF was 2.601 using  $\alpha = 0.05$ , the value of  $t_{\text{table}}$  was 1.678. From the result, it could be seen that  $t_{\text{statistic}} > t_{\text{table}}$ , so, it could be concluded that variable TPF partially has significant effect on equity based financing volume. Thus, the first hypothesis which stated that TPF is positive effect on equity based financing volume was accepted.

The value of  $t_{\text{statistic}}$  of variable ROA was -0.849 using  $\alpha = 0.05$ , the value of  $t_{\text{table}}$  was 1.678. From the result, it could be seen that  $t_{\text{statistic}} < t_{\text{table}}$ . Thus, it could be concluded that profitability (ROA) had no partially significant influence on equity based financing volume. Therefore, the second hypothesis stated that profitability (ROA) had positive influence on equity based financing volume was rejected.

The value of  $t_{\text{statistic}}$  of risk (NPF) variable was 1.513 using  $\alpha = 0.05$ , the value of  $-t_{\text{table}}$  was -1.678. Based on the results, it can be seen that the value of  $t_{\text{statistic}} > t_{\text{table}}$ . Thus, it could be concluded that risk (NPF) had no partially significant influence on equity based financing volume. Therefore, the third hypothesis stated that risk (NPF) had negative influence on equity based financing volume was rejected.

The value of  $t_{\text{statistic}}$  of cost efficiency (OCER) was 2.021 using  $\alpha = 0.05$ , the value of  $t_{\text{table}}$  was 0.678. Based on the results, it can be seen that the value of  $t_{\text{statistic}} > t_{\text{table}}$ . Thus, it could be concluded that cost efficiency (OCER) had partially significant influence on equity based financing volume. Therefore, the fourth hypothesis stated that cost efficiency (OCER) had positive influence on equity based financing volume was accepted.

### 4. Discussion of research result

This section discusses the results of the study in detail.

#### a. Third Party Fund

The first hypothesis states that third party fund (TPF) has a positive influence on equity based financing volume. Based on the t test result, it shows that TPF has positive and significant influence on equity based financing volume. It means that the number of third-party funds has positive effect on the total financing provided Islamic commercial banks and Islamic banking units in Indonesia. Each accretion deposits in Islamic banks and Islamic commercial banking units will increase the total amount of financing provided.

The result of this study support previous study conducted by Mulyadinata (2003) on factors influencing lending (a case study at PT Bank Lampung) and concluded that third-party funding (TPF) influence the amount of lending granted to the public by the management of PT. Bank Lampung. A similar view was also proposed by Pratin and Adnan (2005) which conducted a research on the relationship between saving, equity, nonperforming finance and percentage of profit towards financing on Bank Muamalat Indonesia. They urged that third party fund/ saving has a positive relationship with financing. A similar view was also proposed by Anggraeni (2005), Arisandi (2007) which revealed that the amount of public savings has a significant positive effect on lending. In addition, another inquiry on the loan behavior offered by commercial banks in 2002-2006 conducted by Meydianawhati (2007) reported that third party fund influence the amount of loan offered by commercial banks to small and medium enterprises in Indonesia. Duddy and Nurul (2008) also assessed factors (from supply side) influencing financing volume offered by Islamic banks in Indonesia and concluded that third party fund determine the the amount funds distributed to society in the form of financing. Likewise Siswati (2009), Maharani (2010), Andraeny (2011), Arianti and Pratami (2012) as well as Arianti and Muharam (2012) alleged that that third-party funds has significant positive effect on the volume of Islamic finance in banks.

According to Rose and Kolari (1995), Antonio (2001), and Karim (2004) one of the sources of funds that can be used for financing (loan) is its own capital (equity), so the greater source of funds (equity) possessed by a bank, the higher the amount of funds distributed to customers. Furthermore, in the case of an increasing

amount of capital which is not accompanied by an increase number of financing, the banks will have a substantial amount of idle cash. This condition shall reduce the financing to deposit ratio (FDR) of an Islamic bank. This ratio is estimated by comparing the amount of funds distributed to society with the amount of funds accumulated via savings and other forms. According to regulation of the central Bank of Indonesia, the acceptable level of FDR ratio is around 78-92% (Hamzah, 2013). As a consequence in a situation whereby the amount of third party funds are high, the banks should also find a way to optimally distribute the amount of funds accumulated. The banks has to share the profit to the depositor (mudharib) who place their funds for investment. Provided the proportion of funds received and distributed is not balance, the banks will experience negative spread because the cost of accumulation the funds (in the form of profit sharing) will be higher than the amount of profit received form financing activities. This is also one reason why banks should always set higher rate of profit sharing when they lend the money to society as compared to the rate they shall give to fund depositor (mudharib).

#### **b. Bank Profitability (ROA)**

The second hypothesis states that profitability, in this case the variable is proxied by return on assets (ROA), has a positive influence on equity based financing volume. Based on the partial influence test result, it appears that profitability does not influence equity based financing volume. It means that changes in the amount of ROA shall not alter the total amount of financing provided by Islamic commercial banks and Islamic banking units in Indonesia.

This study is in line with research by Seyed and Makiyan (2001) which examines the impact of profit sharing rate, total deposits, and inflation against Iranian bank loans (which are all Islamic banks) in the period 1984-1994. They concluded that the rate does not significantly influence the results of loans in Islamic banks in Iran. This study also support the result of previous inquiry by Pratin and Adnan (2005) which concluded that profit margin has a negative but not significant influence on financing volume offered by Islamic banks. Similarly, Hapsari (2008) conducted a study on the influence of LDR, NPL, ROA, and ROE to mortgage lending by Rural banks and concluded that ROA did not affect lending decision. A similar finding was also proposed by Pratami (2011) which argue that ROA does not affect financing volume offered by Islamic banks. In addition Arianti and Muharam (2012) urged that ROA did not influence financing volume. This argument was also supported by several other researchers such as Ariati (2012), Wiyati (2012), Pramono (2013) and Anastasya et al (2013).

Pramono (2013) further argue for the reason why ROA does not have significant influence on financing volume because of the imbalance between the total amount of equity financing supplied with the amount of profit sharing received by Islamic banks. Another reason why the ROA does not significantly influence the equity based financing is that this mode of financing carried higher degree of risk.

Return on Assets (ROA) is a measure of the bank's management capabilities within the overall gain. The greater the ROA a bank has, the greater the level of profit that the bank achieved and the better position of the bank in terms of asset security. The phenomenon of Islamic banking in Indonesia shows that there are imbalances portion between the equity based financing volume and *murabahah* financing. Based on the statistics report of Islamic banking in Indonesia provided by Bank of Indonesia in [www.bi.go.id](http://www.bi.go.id) of September 2013, compared to the amount of *murabahah* financing, the portion of equity based financing is much smaller (7.53 percent for Mudarabah and 20.7 percent for musyarakah) while *murabaha* is 60.2 percent. It means that the Islamic banks are tending to do *murabahah* more than the equity based financing. It resulted on the income generated by the Islamic banks are mostly produced by *murabahah*, in this case it has the impact on the effect ROA on equity based financing volume. ROA has no effect on the equity based financing volume because the greater the level of profit that the bank achieved and the better position of the bank in terms of asset security are more influenced by *murabahah*.

#### **c. The Influence of Risk (NPF)**

The third hypothesis states that risk (NPF) has a negative influence on equity based financing volume. Based on the t test result, it shows that risk has no significant influence on equity based financing volume. It means that the value of NPF has no effect on the total financing provided Islamic commercial banks and Islamic banking units in Indonesia. It is similar with the result of a study conducted by Pratin and Akhyar (2005), in their study entitled Analysis of Relationship Savings, capital Alone, NPL, and Markup Percentage Profit Sharing Financing against the Islamic banking deposits and concluded that non performing finance (NPF) did not influence financing volume. A similar view was also proposed by Duddy and Nurul (2008), Budiawan (2008), and Fransiska and Siregar (2007). Moreover, Siswati (2009) concluded in her study that NPF does not have significant influence on the amount of financing. Andraeny (2011) urged that non performing financing doesn't have significant influence on volume of profit and loss sharing based-financing. A similar view was also proposed by Wiyati (2012) and Arianti and Muharam (2012).

Non-performing finance (NPF) is a bad financing which the financing is not collectible. The amount of NPF reflects the level of cost control and financing policies/ credit run by the bank. The more stringent credit



policy/ management analysis conducted by the bank's management, will cause the decreasing level of demand for financing by the public. This is because the processing time of financing takes a longer time and the depth analysis of financing, will affect the prospective customers to feel personally disturbed by feeling that the bank has suspicious on their ability to pay off debts, so that the prospective customers prefer to borrow to other banks which more lenient in performing financial analysis/ credit policy. According Rose and Kolari (1995) and Antonio (2001) cost control have a relationship to the performance of banking institutions, so that the lower the level of NPF, the smaller amount of financing provided by banks, and vice versa.

However the finding of this study suggested that NPF has no significant relationship with equity based financing volume. This indicates that in determining the portion of murabaha financing and equity based financing banks are not inclined to see the level of risk. Another thing that affects the portion financing mode to be distributed to cosumes is a source of capital. Provided the demanded mode equity financing is quite sustantial with a lower expected risk, high propotion of financing shall be distributed in the form of financing. On the other hand, if the perceived risk is high, the amount of financing shall be restricted. Increasing the amount of murabaha financing as compared to equity based financing in Indonesia indicates that investors in Indonesian are risk averter (avoiding risk). Equity based financing volumes tend to be more uncertain than the murabahah, but what should be remembered by investors is that the trade of is high risk is high return.

Moreover, the principle of profit and loss sharing in Islamic banking is interpreted as a form of financing its capital where the return is not determined or guaranteed to be obtained in advance. Contract financing for profit and loss sharing (mudharaba and Musharaka) can be described as a contractual relationship between two parties is governed by Islamic principles, to combine (power) of human and capital funding to implement an investment project that is risky but profitable cooperation. Given the difference in interest between the two parties contained in the contract, in this case the bank as the owner of the funds (principal) channel capital to the customer (agent). These circumstances can bring agency problem, whereby the customer fund managers ignore contractual relations act and not act based on the interests Shahibul Maal. In a mudharaba contract stipulated that the parties are not allowed Shahibul mall to intervene in the management of the business by mudharib, so mudharib have greater private information to the chances of information asymmetry (Maharani, 2008). In short, despite high level of Non performing financing there is a possibility that Islamic banks shall increase the amount of fund distributed in the form equity financing provided they potential customers fulfill the standard safety and thus lower the perceived risks. This phenomena explain the finding that NPF does not affect equity based financing volume.

#### d. Cost Efficiency (OCER)

The fourth hypothesis states cost efficiency (OCER) has a positive influence on equity based financing volume. Based on the t test result, it shows that OCER has positive and significant influence on equity based financing volume. It means that the number of OCER has positive effect on the total financing provided Islamic commercial banks and Islamic banking units in Indonesia. The result supported by the past researches conducted by Yuliani (2007) and Spica and Herdiningtyas (2005), those researches viewed that OCER needs to be done because it affects profit. According to Dendawijaya (2005) the OCER is used to measure the efficiency and ability of banks to carry out its operations. The smaller number of this ratio means the more efficient operating costs incurred by. Islamic banks in the course of its operations should pay attention to its operating costs efficiency ratio (OCER) which indicates the level of efficiency in the operations of banks anyway, which the primary is lending activity in this case is the Islamic bank financing. Operational costs are calculated based on the total sum of interest expense and the total of other operating expenses. Operating income is the sum of total interest income and the total other operating income. In Islamic banks case, there is no interest expenses and interest income, instead there is sharing.

Hassan et al (2009) stated Islamic banks have been efficient in managing its resources, however the efficiency was not accompanied by increased efficiency in generating profits. Thus Islamic banks should ensure high efficiency in its operationa in other words the level of operating costs efficiency ratio (OCER) must be maintained low. The smaller the level of OCER reveals that banks are more efficient in carrying out its business activities. If banks spend more on cost, it will definitely influence profitability of the banks. In shorts, OCER is negatively related to return on assets (ROA). This argument was also supported by Suyono (2005) and Gelos (2006) in Nusantara (2009) revealed that OCER has negative influence on ROA.

According to Amalia (2008) there are several precautions steps that must be followed by Islamic banks to ensure its efficiency (as demonstrated by Bank Syariah Mandiri): The sales officers are targeted based on increasing number of customer bases, increasia financing portfolio, and maintaining the level of financing volume; set up rating on the financial performance of debtors; assessing the financial sources to be relied on by debtors for loan repayment. A similar situation also happen to Islamic banks. They have to ensure that the amount of profit to be earned is higher than the operational cost otherwise they will not be able to payback fund owner/ investor who deposit their fund in the bank. In the case of high OCER ratio, it implies that high expense on low net income, an Islamic banks must increase the portfolio of financing with larger portion of equity based



financing. This mode of financing generate higher return if compared to the other mode of financing. Thus placing larger portion on musyarakah and mudharabah shall speed up the ability of the Islamic bank in earning profit in order to compensate the loss which occur as a result of inefficiency in business operation.

In addition, lower level of profitability as a result of high operational expense (OCER) will motivate Islamic to search for alternative source of funds in order to increase financing volume. One possible source of funds is through debt (larger amount of third party funds or debt from other financial institution or selling bonds) thus the cost of debt in the form of interest will be higher too. Large amount of funds accumulated from the public must be accompanied by proportional amount of funds channeled to the society in order to maintain the banks liquidity. The banks's liquidity is measured by its financing to deposit ratio which according to the Central Bank of Indonesia should be between 85-110%.

Financing to Deposit ratio measures the ability of Islamic banks to meet short-term obligations at maturity. In the context of conventional banks FDR replaced with the term LDR. Islamic banks said to be liquid if it is able to restore depositors' funds at the time billed and able to meet the need for external financing. High level of FDR indicates that the company is considered liquid (Kashmir, 2010). High interest expense will the total amount of operational expenditure therefore higher OCER.

That's why the higher number of OCER, the greater amount of financing provided by banks.

## 5. Conclusion and Implications

### 5.1 Conclusion

Based on the data analysis had been conducted to determine the influence of third party fund, profitability (ROA), risk (NPF), and cost efficiency (OCER), on equity based financing volume, it could be concluded that:

1. Third party fund had significant positive influence on equity based financing volume of Islamic commercial banks and Islamic banking units listed in Bank Indonesia.
2. Profitability (ROA) had no significant influence on equity based financing volume of Islamic commercial banks and Islamic banking units listed in Bank Indonesia.
3. Risk (NPF) had no significant influence on equity based financing volume of Islamic commercial banks and Islamic banking units listed in Bank Indonesia.
4. Cost efficiency (OCER) had significant positive influence on equity based financing volume of Islamic commercial banks and Islamic banking units listed in Bank Indonesia.

### 5.2 Implication

In the effort to increase equity based financing volume, the management of Islamic banks and Islamic banking units listed in Bank Indonesia needs to pay attention on third party fund, and cost efficiency (OCER). One of the ways to do them is by using the powerful promotion techniques to draw the attention of the public in depositing their fund in the bank by demand deposits, time deposits, or savings. Considering the efficiency the banks need to gain more attention in covering the operating expenses. The prohibition of using interest at the Islamic banks impact on the number of operation income gained, this way the Islamic bank have to find another way on gaining income, thus by providing financing. In murabahah financing the Islamic banks required to buy goods which considered by the customers and then sell them to customers concerned at cost which already added by the profit margin agreed between Islamic banks and customers. This kind of financing gives the banks certain profit, but the banks cannot control the number of the margin as the customers have the power for bargaining when the agreement is made. But, the equity based financing volume (mudharabah and musyarakah) leads the bank to invest on business that gives them opportunity to get a greater number of profit. The customers here have lower bargaining power when the agreement is made, as their position is the parties that need to be financed. The profit that they get is not as certain as they get from murabahah, but the opportunity to get the greater amount of profit from the business is higher, while the banks also will receive the sharing as long as the business runs.

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