

The Effect of Third-party Funds and Performing Financing on Profitability of Islamic Banking in Indonesia

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ABSTRACT

The primary objective of this study is to investigate the impact of Third-Party Funds (DPK), Non-Performing Financing (NPF), Financing to Deposit Ratio (FDR), Capital Adequacy Ratio (CAR), and *Mudharabah* Financing on the profitability of Islamic Banking in Indonesia over the period 2020-2024. The research used secondary data obtained from published monthly financial yearly reports of Islamic banking institutions. A quantitative approach was applied, and multiple regression analysis was utilized to examine the relationships between variables. To attain a holistic perspective of fiscal results, profitability was assessed using both Return on Assets (ROA) and Return on Equity (ROE) as primary metrics. The findings indicate that DPK and FDR have a substantial positive influence on both ROA and ROE. While CAR demonstrates a statistically significant upward impact on ROE, its correlation with ROA was found to be negligible. *Mudharabah* Financing significantly affects ROA but does not influence ROE. Meanwhile, Non-Performing Financing (NPF) exhibits no discernible statistical impact on either measure of profitability, suggesting its influence is marginal in this context. *Musyarakah* Financing was excluded from the model due to multicollinearity issues identified during testing. Simultaneously, all independent variables significantly influence profitability. These results suggest that effective financial ratio management plays an important role in enhancing the profitability within the Islamic banking sector.

Keywords: DPK; NPF; FDR; CAR; Profitability

ABSTRAK

Penelitian ini dimaksudkan untuk membuktikan pengaruh DPK, NPF, FDR, CAR, dan Pembiayaan *Mudharabah* terhadap fluktuasi profitabilitas perbankan berbasis syariah yang beroperasi di Indonesia selama kurun tahun 2020–2024. Penelitian ini dibantu oleh data sekunder yang diperoleh dari laporan keuangan perusahaan yang dirilis oleh lembaga perbankan syariah. Pendekatan kuantitatif digunakan, dan analisis regresi linear berganda diterapkan guna membuktikan keterkaitan antar variabel. Profitabilitas diukur dengan memanfaatkan Return on Assets (ROA) dan Return on Equity (ROE) untuk memberikan gambaran yang komprehensif mengenai kinerja keuangan. Analisis data menunjukkan bahwa DPK dan FDR memperlihatkan pengaruh yang positif dan signifikan terhadap ROA dan ROE. Sementara itu, CAR memiliki pengaruh positif dan signifikan terhadap ROE, namun tidak signifikan terhadap ROA. Pembiayaan *Mudharabah* berpengaruh signifikan terhadap ROA, namun tidak berpengaruh terhadap ROE. Sementara itu, NPF tidak menunjukkan adanya signifikansi

terhadap kedua indikator profitabilitas. Pembiayaan Musyarakah dikeluarkan dari model karena adanya masalah multikolinearitas yang teridentifikasi selama pengujian. Pengujian secara simultan menunjukkan adanya pengaruh signifikan dari seluruh variabel independen terhadap profitabilitas. Temuan ini menunjukkan bahwa pengelolaan rasio keuangan yang efektif memiliki peran penting dalam meningkatkan profitabilitas perbankan syariah di Indonesia.

Kata Kunci: DPK, NPF, FDR, CAR, Profitabilitas

INTRODUCTION

As stipulated by the Financial Services Authority (*OJK*), a bank serves as an institution specialized in managing financial transactions, acting as an intermediary in accumulating resources from the public and redistributing back to society in order to support equitable national development, encourage financial growth, and maintain national financial stability. Based on the Law of the Republic of Indonesia (*Undang-Undang Republik Indonesia*) Number 10 of 1998, enacted on November 10 pertaining to the banking sector, “A bank is a business entity that collects funds from the public in the form of deposits and distributes them to the public in the form of credit and/or other forms in order to improve the standard of living of the general public.” This legal foundation underscores the pivotal intermediary role that banks play in channeling resources for national economic development.

In general, the banking system is divided into two main types commonly utilised by the public as a place for saving funds, specifically categorized into conventional and sharia-compliant banking systems. A conventional bank is characterised as a financial entity that provides facilities and services for financial transactions to the public. In terms of institutional capacity and statutory authority, conventional banks operate under a framework that is fundamentally analogous to that of their financial intermediaries, these entities engage in capital mobilization from the general population to facilitate credit disbursement for various borrowers with all operations underpinned by a conventional interest-bearing framework (Wafa, 2017). Meanwhile, an Islamic bank, as defined in Undang-Undang Number 21 of 2008, is a financial entity dedicated to facilitating payment settlement transaction and conducts its business practices in strict adherence with sharia mandates. The enactment of this law by the government further strengthened the position of Islamic banks in Indonesia, considering that Islamic banking institutions operate on the basis of Islamic laws and principles.

Islamic banks strongly avoid the use of the interest system, which falls under the category of *riba*, as it contradicts Islamic law. The Prophet Muhammad Saw. likened *riba* to deceiving an ignorant person for the purpose of purchasing their goods and openly practicing usury in vain with the help of intermediaries. In the Qur'an, *riba* is explicitly forbidden, as explained in Surah Al-Baqarah verse 275, which states: “Those individuals who consume *riba* (usury) are depicted as being unable to rise [on the Day of Resurrection] except in a manner reminiscent of one driven to madness by the touch Satan into insanity... Allah has granted mercantile exchange and has forbidden *riba*.” Consequently, transactions in Islamic banks are replaced with a profit-sharing system. Under this scheme, borrowers share the risks or profits, with the distribution determined based on agreements stipulated in the contractual arrangement (*akad*) (Yumanita, 2005).

Sharia banking in Indonesia was inaugurated through the efforts of the Banking Team of the Indonesia Ulema Council (*MUI/Majelis Ulama Indonesia*) on November 1, 1991, Bank Muamalat was officially constituted as a pioneering entity. Based on data published by each Islamic Commercial Bank (*BUS/Bank Umum Syariah*) and the Financial Services Authority (*OJK/Otoritas Jasa Keuangan*), all the total assets of BUS in 2024 reached approximately 729 trillion Rupiah, with Bank Syariah Indonesia (BSI) holding the largest share at 408 trillion Rupiah (55% of the total). For banks, it is important to maintain financial stability, which can be assessed through profitability levels, as banking institutions that demonstrate solid and sustainable financial performance provide benefits for the public who engage with them. (Hakim et al., 2023).

The author selected Islamic Banking in Indonesia as the object of this study because Indonesia is recognized as the country with the largest Muslim population in the world. Of a population approaching 300 million people, approximately 87% adhere to Islam; therefore, it is reasonable to expect that the Islamic banking industry will continue to experience significant growth in Indonesia. According to the

Ministry of Finance, the market share of Islamic banking has reached 7.72%, exceeding the average growth achieved by the national banking industry.

Several factors can influence fluctuations in the profitability of Islamic banking. Among them are Third Party Funds (*DPK/Dana Pihak Ketiga*), Capital Adequacy Ratio (CAR), the Operational Cost to Operating Income ratio (*BOPO/Biaya Operasional Pendapatan Operasional*), Non-Performing Financing (NPF), Financing to Deposit Ratio (FDR), and others. Circumstances originating outside the entity, specifically inflation or the Bank Indonesia (BI) rate may also affect the movement of profitability in Islamic banking. The present paper explores the factors analyzed to further examine their effect on Islamic banking profitability include DPK, NPF, FDR, CAR, as well as *Mudharabah* and *Musyarakah* financing. DPK is an important factor because through this variable, banks can collect funds from the public, which serve as the main source for banking operations. In fact, DPK managed by banks accounts for about 80–90% of the operational funding used by financial entities (Tofan et al., 2022). NPF measures the level of failure in repaying credit funds by customers, while FDR reflects the bank's capacity to fulfil outstanding financial responsibilities, where a higher FDR ratio indicates higher liquidity levels (Yusuf & Hidayat, 2022).

Furthermore, several variables are incorporated to strengthen the analysis and to examine whether other factors impact the fiscal yield of the Indonesia Sharia financial sector, namely *Mudharabah* financing, *Musyarakah* Financing, and Capital Adequacy Ratio (CAR). Functioning as a regulatory benchmark, CAR is a measure that reflects the adequacy of a bank's capital in covering the risks associated with its assets. If a bank has sufficient capital, it will be able to absorb unavoidable risks, allowing its operational activities to be managed efficiently. This condition is expected to help drive growth in the bank's assets or overall wealth. On the other hand, if the capital is insufficient, it may hinder the bank's activities (Suwarno & Muthohar, 2018). Thus, substantial CAR value demonstrates a higherevaluates profitability level of Islamic banks. CAR also serves as an index that indicates the bank's capacity to absorb the risks of productive assets financed by its own capital. This index evaluates the extent to which the bank's capital is used to manage financial uncertainties arising from its day-to-day operations. Bank capital may come from retained earnings, which involve relatively lower risk, or from external sources such as debt or new share issuance, which carry higher risk (Praja et al., 2018).

Mudharabah financing is one of the financing models provided by Sharia banks to support productive business activities within society. *Mudharabah* is a partnership contract involving the primary investor (*shahibul maal*), which contributes the entirety of the required investment, and the entrepreneurial agent (*mudharib*), which is tasked with managing the business, with profits allocated based on the profit-sharing ratio (*nisbah*) mutually agreed upon by both participants (Saputra et al., 2022). In essence, this financing scheme positions the financial institution as the provider of all required funds while the customer is responsible for preparing and managing the project (Teri & Novitasari, 2020). *Musyarakah* financing is a collaborative agreement between diverse participants to carry out a commercial enterprise, with each involved stakeholder providing capital evidenced by a mutually agreed proportion. The allocation of gains is distributed in accordance with the negotiated formula, whereas any deficits are shared in alignment with each party's primary capital contribution (Mirandha, 2021). In essence, *musyarakah* represents a cooperative partnership in which two or more parties provide capital contributions to run a business, with profits beingcente distributed in accordance with the agreed contract, while losses are shared proportionally based on the share of capital contributed (Putri & Diana, 2022)

This scientific study refers to several theoretical frameworks, including stakeholder theory and agency theory. Freeman (1984) introduced Stakeholder Theory, arguing that a company should not solely concentrate on pursuing profit but also has a responsibility to provide benefits for stakeholders; the distribution of profit sharing aims to maximise and optimise the benefits of various activities while minimising potential losses that may be experienced by stakeholders (Maulida et al., 2023). Agency Theory, pioneered by Jensen & Meckling (1976), is motivated by the notion of human nature, which tends to prioritise self-interest, has limited ability to predict future uncertainties, and generally avoids risks that may arise from mistakes in decision-making (Maulida et al., 2023). The unique dimension of this study is centered around a subsecomprehensive and integrative approach to examining the determinants of Islamic banking profitability by simultaneously employing dual profitability indicators, particularly Return on Assets (ROA) and Return on Equity (ROE), within a single empirical framework, thereby enabling a more nuanced analysis that reveals how identical independent variables may exert

differing, and at times inconsistent, effects depending on the profitability proxy applied; for instance, Capital Adequacy Ratio (CAR) demonstrates a substantial impact on ROE but not on ROA, while *Mudharabah* Financing significantly affects ROA but not ROE, and Non-Performing Financing (NPF) does not significantly determine either measure, thus highlighting that the relationship between financial ratios and profitability is not necessarily linear nor stable, in contrast to the assumptions commonly found in prior studies.

Furthermore, this research contributes to the literature by utilizing data from the 2020–2024 period, covering both the COVID-19 crisis and the subsequent fiscal restoration phase, thereby offering empirical insights into the behavior and resilience of Islamic banking financial variables under conditions of economic uncertainty, a context that remains relatively underexplored in earlier pre-pandemic studies. In addition, the study provides a methodological contribution through the identification and treatment of multicollinearity, particularly with respect to *Musyarakah* Financing, which was rigorously tested by the Variance Inflation Factor (VIF) and was subsequently excluded from the model, thereby demonstrating that not every theoretically relevant financing variable is empirically suitable for inclusion in regression analysis. Moreover, the study advances a more holistic analytical model by integrating multiple categories of financial ratios namely liquidity (FDR), risk (NPF), capital adequacy (CAR), funding (DPK), and financing (*Mudharabah*) into a unified framework, which allows for a more profound insight of the systemic interactions affecting the profitability of Islamic banking, and thus offers a broader and more robust explanatory model compared to prior research that typically focuses on a limited number of variables.

The hypotheses formulated by the author aim to resolve the research problems as well as to confirm or reject the correlation pertaining to the independent and dependent variables in accordance with the issues being studied. The author expects that these hypotheses will provide contributions and support a more comprehensive understanding of the phenomenon that becomes the focus of the research.

Ha₁: It is assumed that DPK has significantly impact on the profitability of Islamic banks in Indonesia.

Ha₂: It is assumed that NPF exerts a negative and significant impact on the profitability level of Islamic banks in Indonesia.

Ha₃: It is assumed that the FDR has a positive and significant impact on the profitability of Islamic banks in Indonesia.

Ha₄: It is assumed that the CAR has a positive and significant impact on the profitability of Islamic banks in Indonesia.

Ha₅: It is assumed that *Mudharabah* financing has a positive and significant impact on the profitability of Islamic banks in Indonesia.

Ha₆: It is assumed that *Musyarakah* financing has a positive and significant impact on the profitability of Islamic banks in Indonesia.

Ha₇: It is assumed that DPK, NPF, the FDR, the CAR, as well as *Mudharabah* and *Musyarakah* financing have a significant influence on the profitability of Islamic banks in Indonesia spanning the timeframe 2020–2024.

Table 1. Operational Research Variables

Variable	Definition	Measurement/formula	Scale
Return on Assets (ROA)	A ratio used to measure the effectiveness of asset management in generating net income for a bank.	$ROA = (\text{Net Income} / \text{Total Assets}) \times 100\%$	Ratio
Return on Equity (ROE)	A ratio that measures how efficiently a bank generates profits from shareholders' equity.	$ROE = (\text{Net Income} / \text{Total Equity}) \times 100\%$	Ratio

Variable	Definition	Measurement/formula	Scale
Dana Pihak Ketiga (DPK)	Total funds collected from the public (savings, checking accounts, time deposits) serve as the primary source of funding for Islamic banks.	Natural logarithm of total DPK ($\ln$ DPK)	Ratio
Non-Performing Financing (NPF)	A ratio that measures the level of non-performing loans relative to total loans disbursed.	$NPF = (\text{Non-Performing Loans} / \text{Total Loans}) \times 100\%$	Ratio
Financing to Deposit Ratio (FDR)	A liquidity ratio that measures the proportion of third-party funds that have been channeled into financing.	$FDR = (\text{Total Lending} / \text{Total Deposits}) \times 100\%$	Ratio
Capital Adequacy Ratio (CAR)	A capital adequacy ratio that reflects a bank's ability to absorb the risks associated with its assets and support its operations.	$CAR = (\text{Bank Capital} / \text{Risk-Weighted Assets}) \times 100\%$	Ratio
<i>Mudharabah</i> Financing	A profit-sharing financing scheme in which the bank provides 100% of the capital and the customer manages the business; profits are divided according to an agreed-upon ratio.	Natural logarithm of total <i>Mudharabah</i> financing ($\ln$ <i>Mudharabah</i>)	Ratio

Source: Researcher (2026)

RESEARCH METHODOLOGY

This analysis implements a quantitative approach as its inquiry methodology, supported by data analysis techniques to test the formulated hypotheses. The analysis is conducted with the aid of Stata version 14.2. The main purpose of using this method is to empirically validate the initial hypotheses proposed earlier. According to Indrawan & Yaniawati (2017), a quantitative method is a scientific research method that concentrates on examining a particular problem within a phenomenon and exploring the potential correlations among variables, including testing causal relationships that show how independent variables influence changes in the dependent variable. The focal point of this research is centred on Islamic banking institutions operating in Indonesia. More specifically, the scope of this study encompasses the Islamic Commercial Banks (BUS) in Indonesia.

The company's financial statements were used as the main source of secondary data in this study, referring to the annual reports focusing on Islamic Commercial Banks (BUS) in Indonesia for the period 2020–2024. Secondary data refers to information obtained indirectly through intermediaries or third parties, or from existing sources, without direct measurement or data collection by the researcher (Indrawan & Yaniawati, 2017). For sampling, this study utilizes purposive sampling, a method that identifies subjects based on a set of specific criteria relevant to the research goals that have been set beforehand, with the aim of acquiring data that best supports the research intended outcomes (Mahmudah & Harjanti, 2016). Resulting in a total sample of 10 Islamic Commercial Banks (BUS) operating in Indonesia.

To maintain the robustness of the results then, the methodological framework in this study includes the application of OLS prerequisite testing, which consists of multicollinearity testing and heteroscedasticity testing. Meanwhile, the multiple linear regression procedure involves the coefficient of determination test, simultaneous testing (F-test), and individual hypothesis testing (t-test). Two separate analyses were carried out since profitability was assessed using two approaches: ROA and ROE.

RESULT AND DISCUSSION

RESULT

The presentation of the study is consistent with the methodological framework detailed in the preceding section using a quantitative approach supported by relevant statistical tests. Classical assumption tests were employed to examine data validity, followed by multiple linear regression analysis to evaluate the statistical significance among variables. The results are presented systematically to ensure that the information obtained can be clearly conveyed to the readers.

The multicollinearity test using the Variance Inflation Factor (VIF) indicates that most independent variables meet the acceptable threshold of $VIF < 10$. However, the *musyarakah* financing variable exhibited multicollinearity and was therefore excluded from the regression model. Additionally, the FDR variable showed a VIF value of 10.87, exceeding the threshold and suggesting potential multicollinearity. This issue is suspected to arise from its relationship with DPK, as both variables recorded relatively high VIF values.

To further investigate this indication, a correlation test was conducted. The results show that the correlation coefficient between FDR and DPK is -0.4146, indicating a moderate negative correlation that does not reach the critical threshold of strong multicollinearity (>0.8). Other correlations, such as between *Mudharabah* and CAR (0.3395) and between FDR and NPF (0.2893), are relatively low. Overall, the correlation matrix suggests that the remaining variables do not exhibit serious multicollinearity. Furthermore, the heteroskedasticity test using the Breusch-Pagan/Cook-Weisberg method yielded a p-value of 0.5739, since this value exceeds the 0.05. This indicates that the regression model does not suffer from heteroskedasticity, and the assumption of homoscedasticity is satisfied.

Multiple Linear Regression Analysis

Coefficient of Determination Test

Table 1. Model Summary Result

Statistic	Variable Y1 (ROA)	Variable Y2 (ROE)
R-squared	0.3261	0.8982

Source: Output from Stata Version 14.2 (processed data)

For the regression on ROA, the R-squared value is 0.3261. This model demonstrates that 32.61% of the changes in ROA are driven by independent variables. The residual 67.39% is derived from factors beyond the focal point of this analysis. Meanwhile, for the regression on ROE, the value of R-squared is 0.8982, signifying that the independent variables (DPK, NPF, FDR, CAR, and *Mudharabah*) account for 89.82% of the variance in ROE. The residual 10.18% is attributed to external factors not included in the current analysis, suggesting that the ROE model has substantially higher explanatory power than the ROA model.

F-Test (Simultaneous Test)

Table 2. Model Summary Result

Statistic	Value for ROA	Value for ROE
Prob > F	0.0134	0.0000

Source: Output from Stata Version 14.2 (processed data)

The probability (significance) values for both ROA and ROE are below the 0.05 significance threshold, which indicates that the independent variables (DPK, NPF, FDR, CAR, and *Mudharabah*) collectively serve as the primary drivers of the dependent variables (ROA and ROE). This result confirms the acceptance of the alternative hypothesis (H_a) and rejects the null hypothesis (H_0). The extremely low p value for the ROE model (0.0000) further reinforces the high explanatory capacity of this model.

T-Test (Hypothesis)**The Effect of DPK, NPF, FDR, CAR, and *Mudharabah* on ROA****Table 3. Results of Multiple Linear Regression Test**

Variable	Coefficient	P-value
DPK	0.0755839	0.011
NPF	0.1196744	0.439
FDR	0.0523442	0.002
CAR	0.0077153	0.560
<i>Mudharabah</i>	0.2443758	0.009

Source: Output from Stata Version 14.2 (processed data)

Regression Model (ROA):

$$ROA = 0.0755839 DPK + 0.1196744 NPF + 0.0523442 FDR + 0.0077153 CAR + 0.2443758 Mudharabah + \varepsilon$$

Based on the regression model for ROA, DPK has a positive coefficient of 0.0755839 ($p = 0.011$), indicating that a one-unit increase in DPK is associated with a 0.0755839-unit increase in ROA. FDR also carries a positive and significant coefficient of 0.0523442 ($p = 0.002$), confirming its positive contribution to asset profitability. *Mudharabah* Financing exhibits the largest positive coefficient of 0.2443758 ($p = 0.009$) among all significant variables, suggesting it has the strongest individual contribution to ROA, while NPF (0.1196744, $p = 0.439$) and CAR (0.0077153, $p = 0.560$) do not significantly influence ROA.

The Effect of DPK, NPF, FDR, CAR, and *Mudharabah* on ROE**Table 4. Results of Multiple Linear Regression Test**

Variable	Coefficient	P-value
DPK	0.0983614	0.015
NPF	-0.1473678	0.482
FDR	0.125953	0.000
CAR	0.2623885	0.000
<i>Mudharabah</i>	0.0266927	0.825

Source: Output from Stata Version 14.2 (processed data)

Regression Model (ROE):

$$ROE = 0.0983614 DPK + (-0.1473678) NPF + 0.125953 FDR + 0.2623885 CAR + 0.0266927 Mudharabah + \varepsilon$$

Based on the regression model for ROE, FDR carries the second-highest significant coefficient (0.125953, $p = 0.000$), while CAR demonstrates the highest significant coefficient (0.2623885, $p = 0.000$), indicating that capital adequacy has the strongest influence on equity profitability. DPK also positively and significantly influences ROE with a coefficient of 0.0983614 ($p = 0.015$). In contrast, NPF shows a negative but statistically insignificant coefficient of -0.1473678 ($p = 0.482$), and *Mudharabah* Financing (0.0266927, $p = 0.825$) does not significantly affect ROE, highlighting that the same variables can produce different effects across the two profitability measures.

DISCUSSION

Effect of DPK on Profitability

The findings confirm that DPK has a positive and significant effect on both ROA and ROE, with coefficients of 0.0755839 ($p = 0.011$) and 0.0983614 ($p = 0.015$) respectively. This result is consistent with the theoretical argument that a greater volume of third-party funds reflects higher public confidence in the institution, which in turn enables the bank to expand its financing activities and generate greater returns (Sriyono et al., 2023). This finding aligns with the prior research of Saripah (2020) and Mahmudah & Harjanti (2016), who similarly found that DPK positively and significantly influences both ROA and ROE in Islamic banks; it also confirms the Stakeholder Theory proposition that increased public participation strengthens the bank's operational and financial foundation.

Effect of NPF on Profitability

The NPF variable does not show a significant influence on either ROA (coefficient = 0.1196744, $p = 0.439$) or ROE (coefficient = -0.1473678, $p = 0.482$), contrary to the theoretical expectation articulated by Astuti & Sari (2021), who argue that a high NPF ratio will negatively affect ROA because poor financing quality leads to increased provision expenses. However, this empirical outcome may be attributed to the fact that during the 2020–2024 period, OJK implemented financing restructuring policies in response to COVID-19, which suppressed the reported NPF values and dampened its discriminatory power in explaining profitability variation. This non-significant finding is consistent with the conclusions of Mahmudah & Harjanti (2016), Putri & Indradini (2024), and Saripah (2020), who also found that NPF does not significantly impact Islamic banking profitability.

Effect of FDR on Profitability

FDR demonstrates a positive and significant effect on both ROA (coefficient = 0.0523442, $p = 0.002$) and ROE (coefficient = 0.125953, $p = 0.000$), indicating that a higher ratio of financing to deposits is associated with improved profitability. This finding is theoretically grounded, as a higher FDR reflects a greater proportion of productive financing disbursed to the public, thereby generating higher income from the profit-sharing scheme and ultimately increasing profitability—consistent with the view of Astuti & Sari (2021). The result is in line with Rahmadi (2017), who found that FDR significantly and positively impacts the growth of both ROA and ROE in Islamic banking, reinforcing the importance of active fund deployment in driving profitability.

Effect of CAR on Profitability

CAR is found to have no significant effect on ROA (coefficient = 0.0077153, $p = 0.560$) yet exerts a positive and highly significant influence on ROE (coefficient = 0.2623885, $p = 0.000$), revealing an asymmetric effect across the two profitability measures. The significant positive effect of CAR on ROE aligns with the theoretical perspective that a higher CAR enables banks to absorb risks more effectively and expand their earning asset base, ultimately yielding higher equity returns (Suwarno & Muthohar, 2018; Praja et al., 2018). The non-significant relationship with ROA may suggest that at the aggregate asset level, increases in capital buffer do not immediately translate into enhanced asset productivity, a finding consistent with Praja et al. (2018).

Effect of Mudharabah Financing on Profitability

Mudharabah Financing significantly and positively affects ROA (coefficient = 0.2443758, $p = 0.009$), with the highest coefficient value among all significant ROA predictors, underscoring its critical role in driving asset-based returns. This result supports the theoretical argument that *Mudharabah*, as a profit-sharing financing scheme, directly contributes to revenue generation from productive activities, thereby improving the bank's return on assets (Saputra et al., 2022; Verizaliani, 2021). In contrast, *Mudharabah* Financing does not significantly influence ROE (coefficient = 0.0266927, $p = 0.825$), which may suggest that while *Mudharabah* contributes to overall asset productivity, its effects are insufficient to enhance equity-level returns, possibly because the equity structure of Islamic banks is influenced more strongly by capital management factors such as CAR.

CONCLUSION

This study empirically confirms that DPK and FDR positively and significantly influence both ROA and ROE of Islamic banking in Indonesia during 2020–2024, affirming their central role as profitability drivers. *Mudharabah* Financing significantly enhances ROA but does not significantly influence ROE, while CAR demonstrates a significant positive effect on ROE but not on ROA, revealing that the

determinants of profitability are not uniform across different measures. NPF does not show a statistically significant impact on either profitability indicator, likely reflecting the dampening effect of OJK's COVID-19 restructuring policies during the observation period, and *Musyarakah* Financing was excluded from the model due to multicollinearity concerns identified through VIF testing.

From a managerial perspective, Islamic bank management should prioritise strategies that increase the collection of third-party funds (DPK) and optimise the financing-to-deposit ratio (FDR), as both variables consistently and positively drive profitability at both asset and equity levels. Management should also focus on strengthening capital adequacy (CAR), particularly as it represents the most influential single predictor of equity returns (ROE), while also expanding *Mudharabah*-based financing products to enhance asset productivity. For policymakers, the findings suggest that regulatory frameworks supporting sound capital management and productive financing deployment—particularly during economic recovery phases are essential to sustaining and improving the profitability of the Islamic banking sector in Indonesia.

Furthermore, this study has several limitations: it is confined to 10 Islamic Commercial Banks (BUS) operating in Indonesia over a five-year period (2020–2024), and the exclusion of *Musyarakah* Financing due to multicollinearity limits the comprehensiveness of the model. Furthermore, the study does not incorporate macroeconomic variables such as inflation and the BI rate, nor does it include operational efficiency indicators such as BOPO, which may also influence profitability dynamics. Future research is encouraged to extend the observation period, incorporate a broader set of variables, apply panel data regression with fixed or random effects, and consider comparative analyses across countries or between Islamic and conventional banks to enrich the understanding of profitability determinants in diverse regulatory and economic environments.

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