

## Determinant of Financial Performance of Islamic Credit and Financing Union (KSPPS) in Salatiga

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### Article Info

Article History:  
Received August 2018  
Accepted October 2018  
Published December 2018

Keywords:  
Financial Performance,  
Capital Adequacy  
Ratio, Non Performing  
Finance, Financing to  
Deposit Ratio, OEOI,  
Capital Structure.

### Abstract

The high growth of Islamic Credit and Financing Union (KSPPS) in Indonesia encounters several problems, and one of which is financial performance. This study attempts to uncover the factors influencing financial performance of Islamic Credit and Financing Union (KSPPS) in Salatiga using Pecking Order Theory (POT) inits analysis. POT explains how company's preference uses fund in doing their operational activity. The expected factors influencingIslamic Credit and Financing Union (KSPPS)'s financial performance are Capital Adequacy Ratio (CAR), Non Performing Finance (NPF), Financing to Deposit Ratio (FDR), Operating Expenses-Operating Income (OEOI), and capital structure. The analysis methodology of this study is multiple panel regression employing software EvIEWS 9. The result of regression test shows that OEOI affects partially towards Return on Asset (ROA). In contrast, the other factors such as CAR, NPF, and capital structure do not have any significant influence towards ROA. The differencesbetween this study and previous studies are on the city-scopefinancial data of Islamic Credit and Financing Union (KSPPS) and the use of POT implemented to explain financial performance.

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p-ISSN 2301-7341

e-ISSN 2502-4485

## INTRODUCTION

The model of micro financial institution which develops quite rapidly in this current decade is Islamic Credit and Financing Union (KSPPS). The role of Islamic Credit and Financing Union (KSPPS) is essential in facilitating unbankable Micro, Small, and Medium Enterprise (MSME) (Susilo, 2016), while at the same time, there are many MSMEs encountering difficulty in accessing credit from bank (Puspitasari & Widiyanto., 2015), whereas capital has significant influence towards MSME's growth (Sari & Kardoyo, 2018). Since the first time of its establishment, the growth of Islamic Credit and Financing Union (KSPPS) in Indonesia shows significant improvement. Islamic Credit and Financing Union (KSPPS) as one of business fields which supports the growth and development of national economy (agent of development) is expected to increase people's welfare. Financial performance assessment is an important factor to acknowledge how well the company's performance during certain period of time (Hartuti & Slamet, 2017).

City of Salatiga is chosen as this study object due to its Islamic Credit and Financing Union (KSPPS)' growth which is not as high as the other regions. It causes the low contribution of financial sector in Salatiga's GRDP. In addition, there is a phenomenon that the growth of Islamic Credit and Financing Union (KSPPS) is not prevalent. Found that there are high assets companies, while there are also the companies which are unaffordably increasing their assets significantly.

In this study, chosen some expected factors influencing financial performance (Return on Assets) of Islamic Credit and Financing Union (KSPPS) in Salatiga. They are Capital Adequacy Ratio (CAR), Non Performing Financing (NPF), Financing to Deposit Ratio (FDR), Operating Expenses-Operating Income (OEOI) and capital structure. Therefore, this study aims to analyze the influence of CAR, NPD, FDR, OEOI and capital structure towards ROA both partially and simultaneously. The theory used as the basis to analyze is Pecking Order Theory (POT). According to (Febriana & Yulianto, 2017) this theory includes sequence pattern of company financing decision to determine an optimal capital

structure, which is choosing internal source, and then external source. Internal source comes from profit on hold and fixed assets depreciation reserves. On the other hand, external source comes from debt and the issuance of equity.

Dendawijaya (2009) Bank Indonesia prioritizes calculation of bank's financial performance using ROA (return on assets), considering that ROA is able to represent the measurement of profitability level as the most fund in this asset is obtained from people's saving. Since the business development capital need is getting higher, while Islamic Credit and Financing Union (KSPPS) is fluctuating, thorough analysis of capital becomes very important.

CAR (capital adequacy ratio) related to the provision of capital needed to cover the loss rising from the assets movement, which most of the fund comes from third party or people. It leads to a condition where the equity has a negative relationship with financial performance. POT asserts that equity issuance is the least-liked funding source to purchase the operational according to company's point of view because of asymmetric information and the expensive cost.

Through the financing activity, Islamic Credit and Financing Union (KSPPS) is able to gain profit sharing from customers. Poor quality of financing means many problems in financing, which will cause decreasing the company's profit.

NPF ratio is the ratio between nonperforming financing and total financing. High NPF will diminish Islamic Credit and Financing Union (KSPPS)'s chance to get profit from distributed financing. According to Pecking Order theory, risk will increase the company's possibility to take external financing. If the profit earned decrease, the shared surplus will lessen. It results negative relationship between NPF and ROA.

Financing to Deposit Ratio (FDR) measures the amount of distributed fund in the form of financing that comes from the fund collected by Islamic Credit and Financing Union (KSPPS), especially people's fund. The great amount of distributed total financing will increase the income gained by the company and the high FDR will increase the company's possibility in obtaining profit, so FDR and ROA will have positive relationship.

The ratio between Operating Expenses and Operating Income indicates efficiency level of operation. If the expense is increasing, while the income is constant, it shows that the company can not run efficiently. The higher OE/OI, the higher the risk of loss the company deals with. POT claims that creating internal financing is hard to do, so external financing is taken either through debt or equity. An efficient company is a profitable company, so that it can lessen the possibility to take external financing. Thus, efficiency (OE/OI) has negative impact towards profitability (ROA).

A capital structure depicts the proportion of company assets funding obtained from long-term debt versus capital. External funding from debt and equity should be proportioned; as a result, it could raise the value of the company. Too high long-term debt makes the company face the feasibility of financial distress as the company is encountered with the onus to fork out interest on loans taken. The higher proportion of long-term debt causes the company endure a high debt burden which will reduce the company's income. This has implications for the low surplus. In accordance with the Pecking Order hypothesis, capital structure (financial leverage) is negatively correlated to profitability. It is because a company with high profit rate will tend to use its retained earnings rather than debt, so that the capital structure is negatively correlated to profitability.

Nowadays, studies that moot the financial performance of micro finance institution especially sharia cooperatives, are still finite. This is for finite data. Several previous studies that have been conducted in analyzing the financial performance of Islamic banks and conventional banks have been carried out such as (Farooq & Khan, 2014), (Hasbi, 2015), (Abduh & Alias, 2014), (Parisi, 2017), (Sanwari & Zakaria, 2013) and others. Meanwhile, related to the Pecking Order theory, (Yulianto, Suseno, & Widiyanto, 2016) conducted a testing of the Pecking Order and Trade Off theories on public companies in Indonesia. The results show the companies studied implement the hierarchy funding according to the Pecking Order theory.

## METHODS

This research is a quantitative study to examine the factors influence the financial performance of Islamic Credit and Financing Union (KSPPS) in Salatiga. The sampling technique used was purposive sampling, while the sample involved 10 companies in Salatiga which were recommended by Salatiga Cooperative and MSME Office.

### Data Collection Technique

This study uses secondary data in the form of Financial Statements of each Islamic Credit and Financing Union (KSPPS) Company during 2012-2016, collected by visiting each sample company in Salatiga.

### Data Analysis Technique

The analytical instrument used in this study is multiple panel regression analysis. The set data are classified in certain categories using tables, and analyzed by using the Eviews 9 program. In this research, the dependent variable is ROA, while the independent variables are CAR, NPF, FDR, OE/OI and capital structure. The ROA relationship model with are arranged in the following functions:

$$ROA_{it} = \alpha_0 + \alpha_1 CAR_{it} + \alpha_2 NPF_{it} + \alpha_3 FDR_{it} + \alpha_4 BOPO_{it} + \alpha_5 SM_{it} + \mu_{it} \dots$$

#### 1. Descriptive Statistics Analysis

Descriptive analysis illustrates the research variables, ROA (Y), CAR (X1), NPF (X2), FDR (X3), OE/OI (X4) and capital structure (X5).

#### 2. Test of Classical Assumptions

In regression analysis, the model must meet the BLUE (Best Linear Unbiased Estimation) criteria. Some problems often found in regression analysis are: normality, multicollinearity, heteroscedasticity, and autocorrelation.

#### 3. Data Panel Regression Analysis

##### a. Model Selection Analysis

In panel data analysis, there are three choices of models carried out: common effect (pooled least square), fixed effect and random effect.

##### b. Hypothesis testing

Hypothesis testing is conducted to find out and test whether the regression coefficient obtained is significant. Hypothesis testing consists of t test, f test and determination coefficient test.

## RESULT AND DISCUSSION

The data in this study included secondary data obtained from the financial statements of each Islamic Credit and Financing Union (KSPPS) Company in Salatiga. The following are the

explanatory statistics of the variables Capital Adequacy Ratio, Non Performing Finance, Financing to Deposit Ratio, Operational Efficiency Ratio, Capital Structure and Return on Assets.

**Table 1.** Descriptive Statistics

	CAR	NPF	FDR	OEOI	CAP	ROA
Mean	0.162800	0.010534	1.257600	0.892400	1.521800	0.043120
Median	0.140000	0.010000	1.200000	0.860000	1.105000	0.030000
Maximum	0.760000	0.015000	3.960000	2.630000	5.900000	0.250000
Minimum	0.010000	0.003000	0.020000	0.370000	0.080000	0.003000
Std. Dev.	0.162800	0.010534	1.257600	0.892400	1.521800	0.043120
Observations	50	50	50	50	50	50

In table 1 above, showed that the amount of data from the Islamic Credit and Financing Union (KSPPS) Companies' Financial Report includes 50 data samples of each Company during the period 2012-2016. By using the pooled data method, samples taken from 10 Companies in Salatiga are multiplied by the number of periods, that is 5 years of financial statement, so the amount of data becomes 50. The lowest (minimum) ROA ratio is 0.003 from KSPPS Ramadana in 2015 and 2016 and the highest (maximum) 0.25, from KSPPS Kamal Family in 2015, then the mean of ROA is 0.043.

The mean of CAR ratio is 0.162 with the minimum data of 0.01 and the maximum data of 0.76. The NPF ratio is obtained at an average of 0.01 with the minimum data 0.003 and the maximum data 0.015. The mean of FDR ratio obtained 1,257 with the minimum data of 0.02 and the maximum data of 3.96. The mean of OEOI ratio is 0.892 with the minimum data of 0.37 and the maximum data of 2.63. The capital structure ratio represents the mean of 1.52 with the minimum point of 0.08 and the maximum point of 5.90.

### Classic Assumption Test

#### Normality

To find out the normality of the data, this study employed the Jarque-Bera coefficient and its

probability (Winarno, 2015: 5.43). Based on the conducted normality test, the score of Jarque-Bera is 2.002762 and the probability is 0.367372. Probability score > 0.05, so that the data are normally distributed. Even though the Jarque-Bera score shows that the data are not normally distributed, according to Winarno (2011: 5.41) if each variable consists of 30 data, it is considered normally distributed.

#### Heteroscedasticity

This study used the Glejser test to detect heteroscedasticity problems. Based on the results of the Glejser test above, the probability score of each independent variable > 0.05, so there is no problem with heteroscedasticity in the model.

#### Multicollinearity

Ghozali & Ratmono (2013) states that a variable is considered to have no multicollinearity if its value is no more than 0.90. According to the results of the multicollinearity test, concluded that there is no multicollinearity problem between the independent variables.

#### Autocorrelation

In autocorrelation test using the dW score, Winarno (2011: 5.29) stated: if the dW value is lesser than dL or greater than (4-dL) then the null hypothesis is rejected, meaning that there is an autocorrelation.

$$dW = 2.530; dL = 1.335; 4-dL = 2.665$$

So that  $dW > dL$ ,  $dw < 4dL$ . Based on the provision above, there is no autocorrelation problem in the model.

### Model Selection

There are three types of approaches which can be used in panel data regression, including the common effect model, fixed effect model, and

random effect model. The first model test is carrying out the Chow Test to determine whether the common effect model or fixed effect model should be used in conducting panel data regression. The Chow Test which results a probability score of F stat lesser than  $\alpha = 0.05$ , leads to a decision that the FEM method is significant in testing panel data, and vice versa.

**Table 2.** Chow Test Result

Effects Test	Statistic	d.f.	Prob.
Cross-section F	28.761701	(9,35)	0.0000
Cross-section Chi-square	106.386972	9	0.0000

Table 2 above shows the Chow test results. Chi Square score is 0,000 which means  $< 0.05$ , therefore according to Chow Test, the most appropriate model is the Fixed Effect Model. The

significant Chow Test results were continued by the Hausman Test to choose between the FEM or REM method. The following are the Hausman Test results.

**Table 3.** Hausman Test Result

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	28.503944	5	0.0000

The Hausman Test results show that the score of Chi Square is less than 0.05. Therefore, the appropriate model according to the Hausman Test is the FEM (Fixed Effect Model). So that in this research the regression would be conducted by using the fixed effect model.

### The Analysis of Panel Data Regression

#### 1. T-Test Statistic

The t-test is conducted to determine the influence of the five independent variables to the dependent variable. The results of the t-test are showed in table 4.

**Table 4.** T-Statistics Test Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.026433	0.016298	1.621881	0.1138
X1?	-0.009996	0.023496	-0.425431	0.6731
X2?	-1.585789	1.108721	-1.430287	0.1615
X3?	-0.003625	0.003782	-0.958308	0.3445
X4?	0.043211	0.006582	6.565039	0.0000
X5?	0.000667	0.001698	0.393087	0.6966

a. Capital Adequacy Ratio

CAR is not significantly related to ROA. The negative CAR coefficient indicates the relationship between these variables with ROA inversely proportional. The CAR coefficient value describes that the increase (decrease) of CAR by 1% will reduce (increase) ROA by -0.009996. Pecking order theory states that companies prefer internal funds to external funds. Publication of new equity is the last choice, therefore the high capital adequacy is negatively related to profitability. That no effect of CAR on ROA might be caused by some Credit Union & Islamic Financing which more focused on strengthening capital so that the increase of assets was also supported by the increase of capital, not only the increase of debt. The capital adequacy owned by Credit Union & Islamic Financing used for its operational activities was unable to generate high profits. These findings are in accordance with the results of study of (Anastasia & Septiarini, 2015), (Ummah & Suprpto, 2015), (Putrianingsih & Yulianto, 2016). Their studies also states that the capital adequacy ratio partially has no significant effect on Return on Assets.

b. Non Performing Finance (NPF)

According to the results of the partial test calculation, the significance score is 0.1615, which means that  $H_0$  is accepted. The second hypothesis states that NPF has no significant effect on ROA. That no effect of CAR on ROA can be due to the small amount of bad debt in Credit Union & Islamic Financing Companies therefore it does not significantly affect the profitability of the Credit Union & Islamic Financing. The negative effect showed by NPF reveals that the higher bad debt recovery in financing management shown in NPF, the lower level of Credit Union & Islamic Financing Company's income reflected in ROA. This finding is in line with the research conducted by (Sukarno & Syaichu, 2006), (M, Ali, & Habbe, 2012).

c. Financing to Deposit Ratio (FDR)

The independent variable of Financing to Deposit Ratio has a probability  $> \alpha$  (5%) which is equal to 0.3445, then  $H_0$  is accepted. It means that the FDR variable is not significantly related to ROA. That no effect of FDR on ROA was caused by the unstable growth and development of the Credit Union & Islamic Financing Companies in

Salatiga, it made the incomplete financing distribution. Moreover, in distributing its financing, the Credit Union & Islamic Financing companies also applied mentoring process, which made the companies cautious in maintaining its liquidity. This finding is in line with the research results of (Anastasia & Septiarini, 2015), (Hakiim & Rafsanjani, 2016) that FDR has no significant effect on ROA.

d. Operating Expenses-Operating Income (OEOI)

The independent variable of OEOI has probability value of 0.000; therefore  $H_0$  is rejected. This means that OEOI relates significantly to ROA. According to the theory of Pecking Order, the OEOI variable based on the result of statistical hypothesis testing shows negative and significant influences to ROA. This means that the efficiency level of Islamic Credit and Financing Union (KSPPS) Company operation, influences against income or "earning" made by the company itself. This finding supports the research result of (Sukarno & Syaichu, 2006) and (Parisi, 2017) saying that OEOI has negative and significant influences to ROA.

e. Capital Structure

From the calculation result of partial test, obtained the probability value of 0.6966. The test result shows that capital structure has positive and non-significant influences to ROA. The theory of pecking order also clarifies why a high-profit company has low debt. For a business institution, the debt structure should not higher than capital in order that the fixed expense is not too high. The relationship between capital structure and positive profitability can be a sign that obligation is not something bad if it can make profits for the members and be made use of effectively. The ratio of high capital structure indicates that Islamic Credit and Financing Union (KSPPS) Company bears the risk of high financial loss; however it also has opportunity to obtain rising benefits. That no effect of capital structure to ROA indicates that Islamic Credit and Financing Union (KSPPS) Companies in Salatiga in maximizing profit tends not to rely on the debt ratio versus equity. This finding is in line with the research result of (Rais, 2015), (Imadudin, 2014).

## 2. Simultaneous Significant Test (F Test)

F Statistics Test basically examines whether all independent variables included in the model influences altogether its dependent variables. Ghozali (2013:62) states if F value is higher than F table,  $H_0$  will be rejected. Based on the table above, value F was counted 58.43563 while significant value is 0.000. The probability of F value statistics was less than 5% (0.05), so that the model of regression transformation was used to predict Return on Asset (ROA) or it can be said that Capital Adequacy Ratio (CAR), Non Performing Financing (NPF), Financing to Deposit Ratio (FDR, Operating Expenses to Operating Income (OEIO) and capital structure altogether influence Return on Assets (ROA).

## Determination Coefficient

Determination coefficient ( $R^2$ ) basically measures how far the model ability in clarifies variation of its dependent variable. The result of model estimates made  $R^2$  value is 0.958973. This meant that the used model could define dependent variable or Return on Assets of 95.89%, while the rest, 4.11%, influenced by other factors which were not included in the model.

## CONCLUSIONS

CAR (Capital Adequacy Ratio) does not influence significantly to ROA (return on assets) on Credit Unions and Islamic Financing in Salatiga for the capital sufficiency of the companies cannot make the target profit. NPF (Non Performing Finance) does not affect significantly to ROA (Return on Assets) on Credit Unions and Islamic Financing in Salatiga for the proportion of bad debt which occurs on the company is in small amount; therefore it does not affect the profitability. FDR (Financing to Deposit Ratio) does not affect significantly to ROA (Return on Asset) on Credit Unions and Islamic Financing in Salatiga as the growth of the Credit Unions and Islamic Financing in Salatiga is not stable yet, so that the distribution of financing is not maximum; in addition, the distributed financing cannot make benefits at the desired level. OEIO (Operating Expenses-Operating Income) influences significantly to ROA (Return on Asset) on Credit Unions and Islamic Financing in Salatiga because

the operational efficiency conducted the company can be carried out, therefore it increases the achieved profit and influences profitability. Capital Structure does not affect significantly to ROA (return on asset) on Credit Unions and Islamic Financing in Salatiga as the long-term debt which is the component of capital structure is used effectively so it increases profits of the company and its members. Based on this research result, several suggestions are proposed: (1) for Credit Unions and Islamic Financing, it is important to pay attention to debtor which has good profitability in financing, this type of debtor should be offered to long-term financing so the company's income can be maintained; (2) for both individual or organization customers, it needs to maintain good relation with creditor especially Credit Unions and Islamic Financing in order to reduce asymmetric information problems and get financing access easily. For further research, it is suggested to involve more research samples so that the research results can depict existing better phenomenon.

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