



Bank Profitability: Comparison Between Conventional And Islamic Bank In Indonesia

Firdayana Akhsan¹, Syamsu Alam², Andi Aswan³

^{1,2,3} Faculty of Economics and Business, Hasanuddin University

Email : ¹firdayanakhsan@gmail.com, ² syamsu.alam60@yahoo.com, ³ andiaswanp@yahoo.com

Abstract

This article discusses to analyse the differences of commercial banks in the United States. Indonesia by comparing Islamic banks and conventional banks as well as analysing the influence of independent variables such as loan to deposit ratio or financing to deposit ratio, non-performing loans or non-performing financing, and fee-based income on the profitability of Islamic banks and conventional banks from 2015-2022. Data obtained from 95 bank entities. The results of this study indicate that there are differences in variables that contribute to profitability found is the variable Non Performing Financing or Non Performing Loan in both conventional banks and Islamic banks. Overall this study found that between Islamic banks and conventional banks are significantly different in their operations and cause variables that have to do with operations to show significant differences supported by regression results which indicate that the NPL or NPF variable is the variable that most affects the profitability of Islamic banks and conventional banks.

Key words: Asset, Bank Profitability, Conventional Bank, , Islamic Bank, Loan

INTRODUCTION

The condition of the global crisis caused by the co-19 pandemic has resulted in the paralysis of the vital joints of the country so that it can trigger the shaking of economic resilience globally, banks as financial institutions can be used as a solution in maintaining economic resilience with a strategic role as intermediation between people who need funds and excess funds (Firdaus et al., 2021). Operationally, banks in Indonesia are divided into 2, namely, Islamic banks based on *profile and loss sharing* (PLS) and conventional banks associated with interest (usury), the current banking system affects earnings management behaviour in terms of income, Profitability in the banking world

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can be measured using 3 indicators, namely Return On Asset (ROA), return on equity (ROE), and Net interest margin (NIM) in conventional banks and net operating margin in Islamic banks because loan interest is prohibited in Islam (Jusni et al., 2019). In Indonesia, references in measuring the level of profitability tend to use the Return on Asset (ROA) ratio because Bank Indonesia, which in this case is the Central Bank of Indonesia, prioritises the profitability of a bank as measured by assets whose funds mostly come from public deposits so that this ratio is considered more representative of the size of bank profitability (Rivandi & Gusmariza, 2021).

Over the past five years, conventional banks have been chronically less profitable than Islamic banks for a sample of commercial banks in Indonesia and even post-crisis shows that weak profitability is an acute concern for conventional commercial banks. The problem of continuously weak profitability is a systematic financial stability problem (El-ekdag et al., 2020). Low profitability can also hinder asset management as proactive impairment occurs, impairment can further reduce profits. In addition, lower profitability can encourage more excessive risk-taking to create higher returns, it is also important that weak profits can encourage banks to reduce assets and thus prevent the transmission of credit to the real economy.

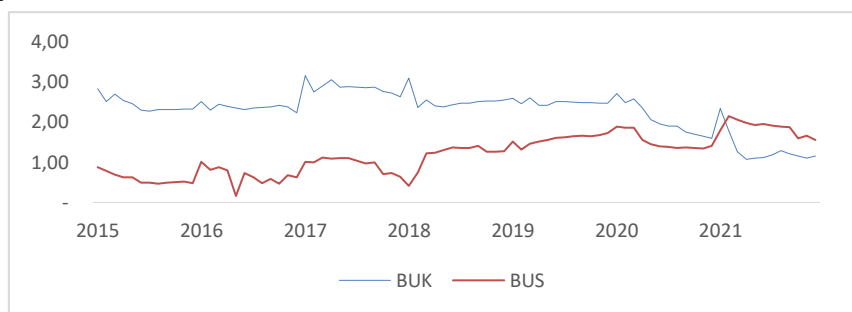


Figure 1. Bank Profitability in Indonesia

This downward trend in profitability occurred during the covid-19 pandemic in 2020, but interestingly Islamic banks only contracted by around 0.2% compared to conventional banks which were worth 2.1% and continued to decline in the following year. The decline in the level of profitability experienced by the bank is not in line with the acquisition of assets and distribution of funds, even though profitability is explained as a measure of how efficient the bank is in managing its assets and profits.

Table 1. Banking assets

	Syariah Bank							
	2015	2016	2017	2018	2019	2020	2021	
Bnk Asset	296262	356504	424181	477327	524564	583948	676735	
Penyaluran Dana	153.968	177.482	189.880	117.895	130.036	137.412	153.639	
	Convensional Bank							
	2015	2016	2017	2018	2019	2020	2021	
Bak Asset	6132583	6729000	7387000	8068000	8562000	9177000	10112000	
Fund Disbursement	3.903.936	4.199.713	4.548.155	5.092.584	5.391.646	5.235.027	5.768.585	

Source: author's calculation from various sources (2023)

Conventional bank asset acquisition experienced an average increase of 9% and average fund distribution activities increased by 7%, but experienced a decline in 2020 by 3% while Islamic bank asset acquisition experienced an average increase of 15% from year to year and its fund distribution activities fluctuated and contracted significantly in 2018 by 38%. In order to fill the gap, it is necessary to conduct a study related to profitability between Islamic banks and conventional banks and what affects the acquisition of bank profitability. Preliminary studies conducted on this topic by (Mehmood & De Luca, 2023; Suropto, 2022; Suzuki et al., 2019; Yanikkaya et al., 2018), examined earnings management and stated that policies in relation to Islamic banking earnings management are more reliable than conventional banks. This finding shows that the earnings management behaviour of Islamic banking is different from conventional banking. The principle of Islamic banks operationally applies mudharabah and musyarakah techniques sourced from classical fiqh to avoid interest (Suropto & Supriyanto, 2021). Another difference from Islamic banks can be seen from the products offered for financing, namely mudharabah and musyarakah, which have higher capital than debt (Azad et al., 2020).

Some findings in previous studies that loans measured by cloans differ significantly between Islamic banks and conventional banks, revealed that conventional banks dominate systems and practices in earnings management (Suropto, 2022). The results of this study are supported by research by wasiaturrehma (2020) on BPR and BPRS through tobit estimation that banks that adopt sharia principles tend to be more efficient than conventional banks in the process of channeling funds (Wasiaturrahma et al., 2020)

The loan ratio of conventional banks has a very strong influence on the level of profitability but not so for Islamic banks (Azad et al., 2020; Yanikkaya et al., 2018). Other studies also reveal that the loan ratio as measured by the Loan to Deposit Ratio (LDR) in banks has a positive and significant impact on profitability, in other words, an increase in loan volume can increase bank profitability as well as corporate welfare (Guan et al., 2021). However, in a study conducted by Murwaningsari, the loan ratio in banks generally has an effect but does not positively affect bank profitability. (Murwaningsari et al., 2019)

Based on observations related to credit management, Islamic bank financing risk management is very good when compared to conventional banks (Akram & Rahman, 2018). In line with the results of Suzuki's research (2019) revealed that there is a very significant difference between Islamic banks and conventional banks (Suzuki et al., 2019). Therefore, Elekdag (2020) examining commercial banks in the European Region found that Non Performing Loan (NPL) is the strongest determinant in affecting profitability (Elekdag et al., 2020). In line with this research, according to Jusni (2019) Non Performing Financing (NPF) is a contributor in influencing profitability in Islamic business units (Jusni et al., 2019). However, a different thing was found by Suripto (2022) in his research which adopted 6 variables, one of which was Non Performing Loan (NPL) that there was no significant difference between the two types of banks in viewing Non Performing Loan (NPL) but it is important to recognise the difference between the two types of banks.

minimise the risks that occur due to the distribution of financing in Islamic banks (Suripto, 2022). Research conducted by Murwaningsih (2019) on the NPL ratio in conventional banking in general and found that NPL is negative to the level of bank profitability (Murwaningsari et al., 2019).

Non-interest income (Fee Based Income) is very important to manage because based on research conducted by Mehmood and De Luca (2023) who examined non-interest income during the COVID-19 pandemic and found a significant increase in non-interest income during the crisis so that it is very helpful in handling the credit risk of a bank (Mehmood & De Luca, 2023). Azad (2019) Azad (2019) also examines the role of fee-based income in a banking entity and finds the effect of fee-based income on increasing bank profitability but has low sensitivity to loans so that dependence on fee-based income can hinder bank growth and sustainable development of a bank (Azad et al., 2020)

LITERATURE ANALYSIS AND METHODOLOGY

Entitas Theory, signaling Theory

The entity theory proposed by Paton (1962) states that the organisation is considered as a unit or business entity, used as a grand theory in this study with the consideration that the company, in this case the bank, is considered as a separate entity that has a need to improve its performance. In this concept, a company as a business organisation is treated differently or in a legal context separately from its owner.

Signaling Theory - In analysing the financial condition of the company, in this case banking, requires clear and transparent information regarding efforts to manage and allocate funds from customers, the signal theory explains the company's motives in providing information related to financial statements which are explained in the form of financial performance.

On the other hand, monitoring and supervision in Islamic banking is very important due to asymmetric information. On the liability side, (Ahmed, 2002) claims that depositors strongly prefer to use Islamic banks for religious or ethical reasons, while bank investors may not necessarily have similar motives, which is also reflected in the murabaha contract, which is fixed income from the asset side. In the concept of universal bank financing musyarakah means that the owner of capital has the right to enter into the management framework so as to have control over the problems created due to asymmetric information, the role of Islamic banks in the context of entrepreneurs (mudharib) on the liability side and as capital providers (rabbul mal) on the asset side (Abdul-Rahman et al., 2014).

Bank Profitability

Based on empirical and theoretical literature, it has been proposed that the main thing that distinguishes between Islamic and conventional banks is the bank's operational system. The main operational activity to earn bank income is deposit mobilisation. Loans are assets transactions between banks and borrowers (economic organisations or individuals in the economy) so that financing or credit in banks can be understood as the relationship of transferring the right to use capital or assets from the bank that demands principal and interest to the lender when payment is due (Wu et al., 2022). Increasing lending activities can benefit banks in increasing market share, revenue, and overall business results (Bhowmik & Sarker, 2021). Therefore, in an effort to avoid credit risk in banking, a good liquidity policy is needed. Liquidity is the ability of a company to meet short-term obligations (debt), this means that if the company is

collected, the company will be able to pay off its debts, especially maturing debts. If the level of liquidity of a bank is high, the level of profitability is also high (Murwaningsari et al., 2019). To measure the level of bank liquidity, the Loan to Deposit Ratio (LDR) is used for conventional banks and the Financing to Deposit Ratio (FDR) for Islamic banks.

Asset Quality: standardised measures of asset quality are used in the risk management matrix, and the level of risk is a key factor driving overall bank performance. The risk of greater returns tends to go hand in hand, at least in the near term. But banks that take on greater risk tend to experience higher losses, and reduced returns. Empirical evidence suggests that higher credit risk (proxied by NPL or NPF) is characterised by lower profitability (Elekdag et al., 2020; Murwaningsari et al., 2019; Suripto, 2022; Suzuki et al., 2019).

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Tabel 2. Previous Reaserch

No	researcher	Variable	Result
1.	(Elekdag et al., 2020)	Real GDP, NPL, ROA, DPK, GDP, Equity	Real GDP growth and NPL ratio are the most reliable medium-term determinants of euro area bank profitability
2	(Suripto, 2022)	Earnings mangjemen, CAR, EBTLLP, CLOAN, firm size, CPI, KURS	So that overall this study shows that conventional banks dominate the system in earnings management practices a.
3	(Murwaningsari et al., 2019)	LDR, NPL, CAR, ROA.	showsthat LDR, NPL, and CAR simultaneously have a significant effect on profitability,
4	(Azad et al., 2020)	Fee Based Income, interest income, Loan To Deposit Ratio	The loan-to-deposit ratio does not affect the profitability of Islamic banks as it does for conventional banks,.
5	(Suzuki et al., 2019)	Musyarakah, leasing.	loans provide a relative Islamic bank leasing opportunity higher,
6.	(Yanikkaya et al., 2018)	NIM, LLP, PDB Riilprice index, bank skale, ATMR, operational price, interest volatiiti, ROA, asset non murabahah,	This result has the implication that the more the use of a financing structure that is more based on the concept of risk sharing will have a positive relationship with IB performance

7.	(Mehmood & De Luca, 2023)	NPL, fee based income, interest income, bank size,	indicating a problematic situation for banks to recover loans from borrowers during the pandemic, increasing the share of non-performing loans
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Data And Reaserch Method

The data used in this study were obtained from the annual reports of commercial banks registered with the Financial Services Authority (OJK). The number of samples is 95 banks, consisting of 85 conventional banks and 9 Islamic banks from 2015 to 2022. This study compares variables of conventional and Islamic banks in Indonesia which include LDr or FDr for liquidity measurement, ROA for profitability measurement, NPL for credit risk measurement, and Fee based income measure to measure other income other than interest and main operations.

Conceptual definition of variables

Tabel 3. Operational definition of variables

No	Variable	Definition	source
1.	Profitability	Bank profitability shows how the bank's ability to earn profits on the assets used in running its business.	(Elekdag et al., 2020; Murwaningsari et al., 2019; Yanikkaya et al., 2018)
2	LDR/FDR	A measure of a bank's level of funds disbursement, increasing lending activity can benefit the bank based on market share, revenue, and overall business results	(Bhowmik & Sarker, 2021; Murwaningsari et al., 2019)
3	NPL/NPF	The main cause of bank failure is bad debts as strong growth in the bank's lending activities can lower the bank's credit quality	(Elekdag et al., 2020; Mehmood & De Luca, 2023; Suripto, 2022)
4.	Fee Based Income	profit derived from transactions provided in other bank services other than spread based or the difference between interest on deposits and interest on loans	(Azad et al., 2020; Mehmood & De Luca, 2023)

Reaserch Method

The analysis used to test the hypothesis has 2 main steps, the first is the Independent T-test to determine the average comparison of two independent data groups. 2 Second, the multiple regression test (T-test) to determine the effect of the independent variable on the dependent variable, and the R-test to see how much the

ability of the independent variable to explain the dependent variable is seen through the adjusted R². The regression equation is formulated as follows:

$$Y_{PROFIT} = \alpha + \beta_1 LDR, FDR + \beta_2 NPL, NPF + \beta_3 FBI + \varepsilon$$

Y = dependen variable coefficient

$\beta_1, \beta_2, \beta_3$ = regression coefficients

PROFIT = Profitability

LDR, FDR = Loan To Deposit Ratio, Financing To Deposit Ratio

NPL, NPF = Non Performing Loan, atau Non Performing Financing

FBI = Fee Based Income

ε = coefficient of error

The interpretation of this independent t-test is as follows:

Sig.2 tailed < α : significantly different (H₀ rejected)

Sig.2 tailed > α : not significantly different (H₀ accepted)

RESEARCH AND RESULTS

Normality test

The data shown Table 4. derived from the Kolmogorov-Smirnov normality test. The table shows that all independent variables have significant values of 0.053 and 0.84, greater than 0.05. this means that the independent variables are distributed to fulfil the assumptions used for comparative and regression analysis.

Table 4. Kolmogorov Smirnov Test

		Unstandardized Residual	Unstandardized Residual
N		628	62
Normal Parameters ^{a,b}	Mean	.0000000	.0000000
	Std. Deviation	1.11023267	1.35748399
Most Extreme Differences	Absolute	.034	.112
	Positive	.034	.064
	Negative	-.028	-.112
Test Statistic		.034	.112
Asymp. Sig. (2-tailed)		.084c	.053c

Source: author's calculation in Multiple regression SPSS ver.25

The data displayed in Table 5. used in testing the second assumption for multiple regression analysis obtained a value of 1,965 for the conventional bank model and 2,183 for Islamic banks. The upper limit value of Durbin Watson in the first model (conventional bank), the table is 1.821 and the second model (Islamic bank) is 1.7104. so that both models meet the Durbin Watson test decision criteria and indicate the absence of autocorrelation in the residuals

Tabel 5. independent of residual Test					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.483 _a	.234	.229	1.06290	1.965
2	.575 _a	.330	.302	4.32290	2.183

Source: author's calculation in Multiple regression SPSS ver.25

The data shown in Table 6. is used to test the regression model and answer the question whether the independent variables can be trusted to predict the dependent variable, the p-value of models 1 and 2 from Table 6. $0.000 < 0.05$ so that the model can be used to predict the dependent variable.

The data shown in Table 7. is used for the next assumption check, namely the absence of multicollinearity between the independent variables. This check is carried out by looking at the value of the variant inflated factor (VIF) < 10 , then it can be said that there is no multicollinearity problem or there is no very high linear relationship between the independent variables..

Table 6. Test of ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	214.086	4	53.522	47.375	.000 ^b
	Residual	702.705	622	1.130		
	Total	916.792	626			
2	Regression	663.286	3	221.095	11.831	.000 ^b
	Residual	1345.496	72	18.687		
	Total	2008.782	75			

Source: author's calculation in Multiple regression SPSS ver.25

Tabel 7. Multikolinearitas Test

Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	LDR	.973	1.028
	NPL	.969	1.032
	FBI bank konvensional	.992	1.008
2	(Constant)		
	FDR	.837	1.194
	NPF	.730	1.369
	FBI bank syariah	.789	1.268

Source: author's calculation in Multiple regression SPSS ver.25

Test of Hipotesis

The data in Tabel 8. is used to test the comparative hypothesis, and shows that the Fee Based Income variable is not significantly different with each value of $0.701 > 0.05$ decision making for the NPL / NPF variable through consideration of equal variance not Assumed because the p- value is $0.000 < 0.05$. And ROA, LDR / FDR and NPL / NPF variables show respectively $0.0010.044$ and $0.032 < 0.05$ so that Return on Asset (ROA), Loan to Deposit Ratio (liquidity ratio) and Non Performing Loan (credit risk ratio) between Islamic banks and conventional banks are significantly different.

Table 8. Independen Sample T-test

		t-test for Equality of Means								
		Equality variance				Sig. (2-tailed)	Mean Difference	Std. Error Difference	Interval of the Difference	
		F	Sig	T	df				Lower	Upper
ROA	Equal variances assumed	103.576	.100	3.317	703	.001	.82393	.24841	.33622	1.31165
	Equal variances not assumed	103.576	.000	1.383	76.008	.171	.82393	.59563	-.36237	2.01024
LDR/FDR	Equal variances assumed	.874	.350	2.015	703	.044	7.84757	3.89414	.20203	15.49311
	Equal variances not assumed			2.410	105.966	.018	7.84757	3.25563	1.39295	14.30219
NPL/NPF	Equal variances assumed	47.933	.000	-4.834	702	.000	-1.69053	.34975	-2.37720	-1.00385
	Equal variances not assumed			-2.185	76.579	.032	-1.69053	.77376	-3.23141	-.14964
FBI	Equal variances assumed	.252	.616	.362	703	.718	.00777	.02147	-.03439	.04992
	Equal variances not assumed			.385	97.550	.701	.00777	.02016	-.03224	.04778

Source: author's calculation in compare t-test SPSS ver.25

Based on the Regression test in the table Table 9. Shows the NPF variable in Islamic banks and NPL in conventional banks affects profitability proxied in the Return on Asset (ROA) ratio with a significance value of $0.000 < 0.05$ and a t-count value of -10.41 and -4.816 respectively, which indicates a negative effect, meaning that an increase in NPF in Islamic banks and NPL in conventional banks will reduce profitability. Meanwhile, LDR and FBI variables have no influence on profitability in both conventional and Islamic banks.

Tabel 9. Test of Multiple Regression

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.025	.163		12.436	.000
	LDR	.003	.001	.069	1.854	.064
	NPL	-.238	.023	-.387	-10.410	.000
	FBI bank konvensional	.415	.250	.061	1.658	.098
2	(Constant)	3.433	1.905		1.802	.076

FDR	-.005	.021	-.027	-.261	.795
NPF	-.419	.087	-.544	-4.816	.000
FBI bank syariah	-1.715	3.417	-.054	-.502	.617

Source: author's calculation in Multiple regression SPSS ver.25

DISCUSSION

Based on research related to comparative analysis, it is obtained that variables that are significantly different between conventional banks and Islamic banks are Return on Assets (ROA), LDR / FDR (Loan to Deposit Ratio / Financing to Deposit Ratio) and those that have no difference are Fee-based income variables because the acquisition of fee-based income between conventional banks and Islamic banks goes through the same process, where the acquisition of non-operating income for Islamic banks and conventional banks goes through the same process, namely obtained from fees to commissions for services, this is in accordance with previous research by (Niu & Hasan, 2019; Sopian & Pramiudi, 2021). These results can also be strengthened by regression tests conducted that the Fee Based Income variable has no effect on profitability, due to bank activities related to fees only have small switching costs due to their short-term nature and problems arising from bank dependence on non-interest activities can cause agency problems and moral hazard because by increasing agency costs are higher than revenue costs. This is reinforced by research conducted by (Mehmood & De Luca, 2023) which states that Fee Based Income will only increase credit risk so as to cause income diversification.

In the regression analysis conducted, in addition to finding the Fee Based Income variable which is not significant, the Loan to Deposit Ratio and Financing To Deposit Ratio variables also show results that do not affect profitability as measured by the Return on Investment ratio On Asset (ROA), due to the high FDR or LDR ratio causes bank liquidity problems, the bank will have difficulty in fulfilling all obligations that must be paid immediately. One condition is if there is a sudden withdrawal of third party funds by the customer, so that the bank must use inter-funds (Call Money) to meet these obligations, in addition, the low FDR / LDR value indicates that the bank is not performing its function as an intermediary, because the third party funds collected by the bank are greater than the distribution of funds. This causes the liquid assets to be high, the research is consistent with that conducted by (Murwaningsari et al., 2019) which also says that liquid assets are less likely to provide high results, besides that (Azad et al., 2020) also in his research found that the ratio of loans to third party funds (LDR ratio) does not affect the acquisition of bank profitability

CONCLUSION AND RECOMMENDATIONS

The conclusion of this study based on the data obtained from 95 banking entities analysed comparatively and regressively from 2015-2022, the findings indicate that the variables of Return On Asset, Non Performing Loan / Non Performing Financing, and financing to deposit ratio / loan to deposit ratio are variables that differ between conventional banks and Islamic banks while the variable fee-based income is a variable that is not significantly different between conventional banks and Islamic banks and the variable that contributes to profitability is found to be the variable Non Performing Financing or Non Performing Loan in both conventional and Islamic banks. Overall, this study found that between Islamic banks and conventional banks are significantly different in their operations and cause variables that have to do with operations to show significant differences supported by regression results which indicate that the NPL or NPf variable is the variable that most affects the profitability of Islamic banks and conventional banks.

This study fills the gap in the existing literature to investigate the determinants of profitability between conventional and Islamic banks which is only limited to the use of a panel of information that is only limited to five years, and is not sufficient to validate the consistency of the results. Future studies need to add a wider period and location of data collection to provide findings with greater capacity.

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