A COMPARATIVE ANALYSIS OF
ISLAMIC AND CONVENTIONAL BANKING
IN TERMS OF FINANCIAL PERFORMANCE
IN THE PERIOD OF 2006–2013
(A CASE OF ISLAMIC AND STATE OWNED BANKS
LISTED IN BANK OF INDONESIA)

By

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The Panel of Examiners declare that the skripsi entitled “A Comparative Analysis of Islamic and Conventional Banking in terms of Financial Performance in the Period of 2006 – 2013: A Case of Islamic and State Owned Banks Listed in Bank of Indonesia” that was submitted by Vira Az-Zahra Julestica majoring in Management from the Faculty of Business was assessed and approved to have passed the Oral Examinations on 18 February 2014.

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This skripsi entitled “A Comparative Analysis of Islamic and Conventional Banking in terms of Financial Performance in the Period of 2006 – 2013: A Case of Islamic and State Owned Banks Listed in Bank of Indonesia” prepared and submitted by Vira Az-Zahra Julestica in partial fulfillment of the requirements for the degree of Bachelor of Economics with a concentration of Banking and Finance in the Faculty of Business has been reviewed and found to have satisfied the requirements for a skripsi fit to be examined. I therefore recommend this skripsi for Oral Defense.

Cikarang, Indonesia, January 28, 2014

Acknowledged by, Recommended by,

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I declare that this skripsi, entitled “A Comparative Analysis of Islamic and Conventional Banking in terms of Financial Performance in the Period of 2006 – 2013: A Case of Islamic and State Owned Banks Listed in Bank of Indonesia” is, to the best of my knowledge and belief, an original piece of work that has not been submitted, either in whole or in part, to another university to obtain a degree.

Cikarang, Indonesia, January 28, 2014

Vira Az-Zahra Julestica
ABSTRACT

The objective of this study was to compare financial performance between Islamic and state Owned conventional banking during period 2006 – 2013 registered in Bank of Indonesia. The study analyzed four banks which were PT Bank Syariah Mandiri, PT Bank Muamalat Indonesia, PT Bank Tabungan Negara and PT Bank Negara Indonesia. The parameters used to compare their financial performance were several financial ratios that include Capital Adequacy Ratio (CAR) as capital adequacy assessment; Return on Assets (ROA), Return on Equity (ROE) and Operational Efficiency Ratio (OER) as profitability assessment; and Loan-to-Deposit Ratio (LDR) as liquidity assessment. The method used is Independent t-test where this study is to compare samples from two different populations. This study used secondary data that was collected and obtained from financial publication report quarterly published by representative banks through the banks’ official sites and official site of Bank of Indonesia starting from March 2006 to September 2013. The result showed that CAR, ROE and LDR significantly differed between Islamic and state Owned conventional banks whilst ROA and OER were two variables that showed Islamic and state Owned conventional banks were not significantly different.

Keywords : Capital Adequacy Ratio, Return on Assets, Return on Equity, Operating Efficiency Ratio, Loan-to-Deposit Ratio
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CHAPTER I

INTRODUCTION

1.1 Background of the Study

A quote says, “A country will have no heart beating with no economy.” An economist, Prof. Noel T. Palmer, revealed his thought as the quote and he stated that economy would always impact on the country’s health in which economic growth has huge possibility to increase level of productivity in many sectors, including banking. Banking sector provides more percentage in the money circulation in every single country over the world. According to Gobat (2013), banks play an important role in all matters of economy. Creating money, making loans and transmitting monetary policy are several functions that every bank has. Therefore, in the global area, banking sector has been facing difficulties in critical matters over the years for variety of reasons.

The major raised bobber happens for banking world when a country should cope with economic crisis. In Indonesia, the country had ever struggled in a whacked economic crisis in the year of 1997. Hermana (2007) straightly said that the crisis in 1997, called Asia Crisis, caused enormous negative effects for banking industry in Indonesia. Even, the government decided to forcibly close 16 conventional banks in order to cure the stability of economic. Based on annual monitoring report by Bank of Indonesia in 2004, the number of conventional banks declined piercingly affected
by the crisis.
From Figure 1.1, there are two periods pre-crisis (1988 – 1997) and pasca-crisis (1988 – 2004) and significantly after economic crisis, total of conventional banks were declining because many banks could not stay strong facing the crisis and then they were bankrupt. As per record from Bank of Indonesia, within 6 years from 1997 to 2006, there were 18 conventional banks liquidated by government, 10 banks stopped to operate, 42 banks stopped to run business activities, 28 banks did merger and 2 banks initiatively liquidated.

This big happening has encouraged every conventional bank to create strategic planning to struggle and improve better development. Furthermore, in the 2008/2009 there was another global economic crisis which caused by a financial crisis in the US starting in 2007. Darmawan & Yamauchi
(2010) found that Indonesia absolutely got the impact during the crisis. The impact was reflected starting in October 2008 in which overall growth rate for 2008 in Indonesia was only 6.2% declined from 6.8% in the previous year, 2007 (as cited in Tambunan, 2010). As stated in Bank of Indonesia annual report in 2010, the financial crisis hit Indonesia
up to the end of 2009 where Bank of Indonesia had done preparing programs or projects to cure the economic condition affected by the crisis in 2008/2009 and the condition was on the right track in multi speed during 2010.

On the other hand, besides the banks should struggle in crisis, there is also internal competition in banking sector itself to get more and more customers. It can be said as well as each and every day, people are subjected to tons of banking advertisement from numerous sources, including television, newspapers and magazines, radio, and the Internet. Banking industry in Indonesia has been experiencing the moment of racing against each other among all banks. Widyastuti & Armanto (2013, p.2) analyzed that the competition between bank in Indonesia has been rising in Indonesia since a policy (PAKJUN) regarding openness in banking sector on June 1, 1983 in the purpose of modernizing banking system and a policy (PAKTO) in October 27, 1988 regarding an easiness to establish new bank, including branches. It is proven that currently Indonesia has more than 100 banks around the country and they are still competing with each other to create more popularity and attract more customers to come in. Yet, most of conventional banks started to give up standing alone by their own management and funds. Gie (2013) on his article about Bantuan Likuiditas Bank Indonesia (BLBI), the content of investigation audit report No. 06/01/Auditama II/AI/VII/2000 on July 31, 2000 states
Bank of Indonesia (BI) did not stop to perform clearing to the conventional banks that already in the status of overdraft in the huge amount and long period of time. This report implicitly revealed that entering new century, conventional banks in Indonesia do not perform an expected result which more driving slowly.

At this time, since 2000s, a new banking system is step-by-step beating conventional banking. Based on a summary analysis titled “Perkembangan dan Prospek Perbankan Syariah Indonesia: Tantangan Dalam
Menyongsong MEA 2015” written by Deputy Governor of Bank of Indonesia, Dr. Halim Alamsyah, until February 2012, Islamic banking in Indonesia has network of 11 public Islamic banks (Bank Umum Syariah), 24 Unit Usaha Syariah and 155 Bank Perkreditan Rakyat Syariah (BPRS) with the total assets of approximately IDR 298.6 trillion in which 51,1% increased than 2011. This number officially makes Islamic banks getting one level ahead rather than conventional banks. Alamsyah (2013, p.3) explained that Islamic banking in Indonesia is able to demonstrate such a high growth acceleration with average number of 40.2% per year in the five years ending (2007 – 2011), meanwhile conventional banks only got around 16.7% per year of their growth. Thereof, Islamic banks arise as the fastest growing industry in banking sector that cannot be simply ignored.

The year of 1992 became the birth year of Islamic banking in Indonesia in which the first Islamic bank, Bank Muamalat Indonesia, established. Despite the late development compared to other Islamic countries such as Pakistan, Saudi Arabia and Malaysia, Indonesia showed a rapid growth of its Islamic banking sector. Karim (2005, p.23) said that in 2005 the number of Islamic banks has become 20 units and by this development, the prospect of Islamic banking in 2005 would be quite promising. Nowadays, Islamic banking becomes a phenomenon when one finds that a large number of Islamic banks are operating around the world, even side by side with the
conventional banks. In addition, Ahmad (2009, p.237) stated that the economic crisis occurred in 1997 gave less effect to the Islamic banks in the entire of Southeast Asia included Indonesia because during the crisis the major problem is that Indonesian interest rates skyrocketed thus it gave more impact on conventional banks that used the interest rate regulation in their banking activities.

When all conventional bankers find out this as a threat for their future in reaching customers’ trust, they give the best effort to improve their performance in many aspects especially financial one, so do Islamic
bankers. Through financial performance, they could create more value as a bank because they might get a beneficial trust from the depositors, finance managers, regulators or even investors regarding investment level. Investors still prefer to invest to conventional banking rather than to Islamic banking. This statement might be caused by people who most of them still cannot place reliance to Islamic banks especially in investment (Mu’allim, 2005). The main reason why investors still doubt to invest in Islamic banks is that system of Islamic banks prioritizes the benefit along with equitable distribution of income which is not reliable in interest rate rules. As cited in a research done by Puspitaningrum & Triyuwono (2008), according to Bank of Indonesia, in contrast to the system of interest which is believed that interest rates will give impact on investment flows, higher interest rates derives higher level of public investment flows to the bank itself. In additional, Business Director of PT Bank Negara Indonesia, Imam Teguh Saptono, concluded that even in 2013, although Islamic banks have been developing rapidly in banking sector, Islamic banks still have problem in getting funds, investment or savings even more institutional funds are still doubtful to enter Islamic banks. Therefore, to attract such these investors, Islamic banks alternatively put higher efforts to increase their performance in financial aspect.

From Ernst & Young UK Global Banking and Capital Markets leader’s survey, Bill Schlich, a successful corporate
banking is when the bank can keep customers close with them by improving the financial performance. In the survey, one of core criteria for overall bank performance is measured by stability of financial performance. Schlich tried to publish that from two-thirds of their executives, 76% agreed that financial performance becomes a top criterion as bank performance indicator for all investors and depositors. In a highly competitive financial market bank performance provides signal to depositor-investors whether to invest or withdraw funds from the bank. It can be said that investors hold an important role to lift the popularity of the bank as well. Having more
investors to invest means a great opportunity to get new customers to save their money and be loyal customers at the bank.

Being introduced to these two different banking systems; Islamic and conventional banking, the researcher finds out that analyzing financial performance between both banking systems is a good research topic for banking performance analysis, especially in financial management strategy for the banks. To practically analyze the comparison between Islamic and conventional banking focusing on financial performance used several financial ratios, the researcher will choose 4 banks in total from Islamic and conventional banks which have been registered and listed in Bank of Indonesia. The researchers will compare financial data from PT Bank Syariah Mandiri and PT Bank Muamalat Indonesia. Meanwhile, the conventional banks are all state owned banks which are PT Bank Tabungan Negara and PT Bank Negara Indonesia.

In this research, the researcher will figure out all of measurement and assessment result in financial aspect for Islamic and conventional banks by using several financial ratios as analysis tools which will reflect capital adequacy, profitability and liquidity of the banks.

1.2 Problem Identification

Currently, banking industry introduces different kind of
banking systems which are Islamic and conventional banking. Although conventional banks have been foreknown developing instead of Islamic banks, the number of Islamic banks arises with great growth in the economy. Unfortunately, Islamic banks need to ensure people outsides including investors to put their money on the banks. This issue makes an interesting healthy competition in the internal of banking industry in Indonesia between Islamic and conventional banking. Thus, through financial performance, Islamic and conventional banking will be assessed further. Usually, people
can be attracted by issues in the media but financial performance has been an important factor for the banks themselves to prove whether they are better than others because the healthier the bank’s financial performance, the more good things come to the bank including people’s trust.

This skripsi will examine the differences between Islamic and conventional banks in terms of financial performance measured with some relevant analysis ratios. The banks are purposively chosen which are PT Bank Syariah Mandiri and PT Bank Muamalat Indonesia representing Islamic banking system. In conventional banking, they are PT Bank Tabungan Negara and PT Bank Negara Indonesia. This comparative analysis is entitled A Comparative Analysis of Islamic and Conventional Banking In Terms of Financial Performance in the Period of 2006 – 2013: A Case of Islamic and State Owned Banks Listed in Bank of Indonesia where the researcher will elaborate three financial ratio groups for the performance analysis:

a. Capital Adequacy → Capital Adequacy Ratio (CAR)
b. Profitability → Return on Assets (ROA), Returns on Equity (ROE) and Operating Efficiency Ratio (OER)
c. Liquidity → Loan to Deposit Ratio (LDR)

1.3 Statement of the Problem

The research will be carried out by analyzing the comparison of two banking types in Indonesia which are Islamic and Conventional banking in terms of the financial performance to be used for assessing which one reflects better financial condition in the period of 2006 – 2013 in terms of capital adequacy, profitability and liquidity aspects. These are some problems which the research needs
to find out in the finale result of the research as mentioned below:
1. Do Islamic and conventional banks differ significantly in capital adequacy by using CAR in the period of March 2006 – September 2013?

2. Do Islamic and conventional banks differ significantly in profitability by using ROA in the period of March 2006 – September 2013?

3. Do Islamic and conventional banks differ significantly in profitability by using ROE in the period of March 2006 – September 2013?

4. Do Islamic and conventional banks differ significantly in profitability by using OER in the period of March 2006 – September 2013?

5. Do Islamic and conventional banks differ significantly in liquidity by using LDR in the period of March 2006 – September 2013?

1.4 Research Objectives

The main objective that the research carries out is about to analyze the comparison between Islamic and conventional banks in Indonesia in terms of their financial performance. The banks are taken from several Islamic and conventional banks listed in Bank of Indonesia which are a) Islamic banks (PT Bank Syariah Mandiri and PT Bank Muamalat Indonesia), and

b) Conventional banks (PT Bank Tabungan Negara and PT Bank Negara Indonesia).

The researcher also aims to achieve these specific objectives of this skripsi as follow:

1. To identify and figure out whether financial performance between Islamic and conventional banks is significantly different in terms of
capital adequacy by using CAR in the period of March 2006 – September 2013.
2. To identify and figure whether financial performance between Islamic and conventional banks is significantly different in terms of profitability by using ROA in the period of March 2006 – September 2013.

3. To identify and figure out whether financial performance between Islamic and conventional banks is significantly different in terms of profitability by using ROE in the period of March 2006 – September 2013.

4. To identify and figure out whether financial performance between Islamic and conventional banks is significantly different in terms of profitability by using OER in the period of March 2006 – September 2013.

5. To identify and figure out whether financial performance between Islamic and conventional banks is significantly different in terms of liquidity by using LDR in the period of March 2006 – September 2013.

1.5 Significance of the Study

This study is significant on many counts and would give important significance to related parties in the field of economics and educational research and development as follow:

a. Banking Sector: The study is expected to be one of references, learning points or assessment that can be used for determining how Islamic and conventional banking perform in Indonesia.

b. Investors: The study is set to assist investors adding their consideration aspects before planting an investment whether into the Islamic or conventional banks because the comparative analysis using financial metrics is assigned to be a part of assessment for bank performance.

c. Students: The study would definitely enhance the knowledge to the students especially for Faculty of Business students to learn
about Islamic and conventional banking system in Indonesia
which is different each other according to their financial performance. Also, the students can learn how to use and identify financial ratios.

1.6 Definition of Terms

1. Capital Adequacy
   A single number expressed financial strength of the bank as a ratio of its capital to its assets.

2. Capital Adequacy Ratio (CAR)
   A ratio used to measure bank’s ability to meet its obligations to account holders and ensure that the bank is able to handle losses

3. Conventional Banking
   A banking system that provides financial services with interest rate, such as accepting deposits, giving business loans and auto loans, mortgage lending, and basic investment products.

4. Financing to Deposit Ratio
   A terminology used in Islamic banking system which is same as LDR that reflects level of bank’s liquidity.

5. Interest
   A fee charged for the privilege of borrowing money, basically expressed as an annual percentage rate

6. Islamic Banking
   A banking system based on the principles of Islamic law and guided by Islamic economics frame.

7. Liquidity
   The degree to which bank’s assets can be easily converted to cash without affecting the asset’s price.
8. *Loan to Deposit Ratios*

A tool to assess a bank's liquidity by dividing the bank's total loans by its total deposits.
9. **Operating Efficiency Ratio (OER)**

A financial ratio measured how efficient the bank’s management performs by comparing its operating expense to operating income.

10. **Profit Sharing**

Various incentive plans that a bank or company provides direct or indirect payments to employees that depend on company’s profitability.

11. **Profitability**

A business's condition when the business generates earnings as compared to its expenses and other relevant costs incurred.

12. **Return on Asset (ROA)**

An indicator to find out how profitable a company is relative to its total assets.

13. **Return on Equity (ROE)**

An indicator to measure a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

---

I.7 **Scope and Limitations**

1.7.1 **Scope**

The study examines the comparison between Islamic and conventional banks in terms of financial performance using 5 ratios in total as tools measured capital adequacy, profitability and liquidity of the banks. All data and information is collected through secondary financial report and any related instruments. The secondary data will be
collected from journals, financial reports, previous researches or articles about Islamic and conventional banks taken from trustworthy source.

1.7.2 Limitations

a) The research will consist of financial performance analysis for 4 banks which are listed in Bank of Indonesia; In Islamic banking, PT Bank
Syariah Mandiri and PT Bank Muamalat Indonesia. In conventional banking, they are PT Bank Tabungan Negara and PT Bank Negara Indonesia.

b) The research will use 5 financial ratios in terms of capital adequacy (CAR), profitability (ROA, ROE and OER) and liquidity (LDR).

c) The research data and information will reflect the condition happening in the period of March 2006 – September 2013.

1.8 Research Benefits

Final result of the research will be beneficial for many parties such as: For Students:

a) To learn more about Islamic banking system.

b) To let students acknowledge about the components that would be different between Islamic and conventional banks.

c) To add reference in writing papers or journals that has related topics with the research.

d) To find out in what aspect each type of banking that is better than the other by evaluating the financial performance analysis.

For Islamic and Conventional Banks:

a) To add more empirical study and research in the purpose of performance improvement and development.

b) To predict how to manage their financial management better with internal condition for each bank in the future in order to attract more customers in.

For Educational Institutions:

a) To add more learning material for the students especially in Faculty of Economics, Banking and Finance concentration.

b) To consider Islamic Banking as a new subject to be delivered to the students.
For Banking Consumers:
   a) To have more insight and knowledge to the Islamic and conventional banking.
   b) To create more consideration in terms of financial aspect for choosing which one type of banking that would be their banks to consume.

For Investors:
   a) To add more consideration before investing whether to Islamic or conventional banks.

For Future Researchers:
   a) To add more references and secondary data collection in order to help and support the progress of research.
   b) To inspire and encourage future researchers for enhancing and improving the research.
   c) To do comparison study for same case study in different research location and objects.
CHAPTER II

LITERATURE REVIEW

2.1 Theoretical Review

2.1.1 Definition of Bank

A definition of bank taken from the book “Bank and Financial Institution Management” written by Rivai et al (2007, p.321), Howard D. Crosse and George J. Hemple stated that bank is an organization in which the collaboration of human acts and financial sources to serve people and gain the profit for bank’s owners themselves. Another statement concerning on what exactly the bank is, Prof. G. M. Verryn Stuart on his book “Bank Politic”, bank is defined as an entity that aims to provide credit, either with their own money or borrow from others then circulate the heat exchanger in the form of banknotes and demand deposits (as cited in Rivai et al., 2007, p.321). Rose & Hudgins (2008) defined a bank in terms of three categories:

1. The economic functions

   Bank is an entity involved in transferring funds from savers and borrowers (financial intermediation) and in paying for goods and services.

2. The services to customers

   Bank is an entity that provides great financial services from checking accounts and savings plans to loans for business, consumers and also government.
3. The legal basis for its existence

The government of United States settled on a definition that a bank is any business offering deposits subject to withdrawal on demand and making loans of a commercial or business. Also, the Congress of U.S.
defined “A bank as any institution that could qualify for deposit insurance administered by the Federal Deposit Insurance Corporation (FDIC)”.

On the other hand, the government of Indonesia puts a definition of bank in the Laws No. 10, 1998 regarding banking in which bank is a business entity that raises funds from the public in the form of savings and channels them to the public in the form of credits or other forms to improve public’s lives a lot.

2.1.2 Introduction to Islamic Banking

In the life point of view, in general, Islam always offers such a way of life with social, economic and financial principles of its own to lead people for reaching a better life and goals. Therefore, Islamic economics and finance have great potential for aligning the resources with economic, financial and social needs of society. In last decade, many researchers make Islamic finance industry as a subject of many studies and papers along with the significant growth in that industry. Indeed, currently Islamic banking system has completely emerged as a new competitive rival or even substitute for the conventional banking system. Ahmed (2009) simply mentioned on his study that even more the U.S. had done a study conducted by Merrill Lynch in 1996 which predicted that future decades will include Islamic assets management as potential outcomes for the states.
The Islamic banks have been really famous about their different products produced by conventional banks. According to Arieff & Iqbal (2011), these new niche banks have introduced Islamic products which are based on the principles of interest avoidance, risk sharing and profit sharing security. To get to know more about Islamic banks, below is the in-depth knowledge regarding Islamic Banking in general including its definition,
principles, instruments, financial activities and how Islamic banks perform in Indonesia in the current time.

A. Definition of Islamic Banking

According to Banking Indonesia’s Law No. 21, 2008 regarding Islamic Banking, the definition of Islamic banking is a financial activities implemented by Islamic banks and Islamic Business Unit where there is a relation with Islamic principles. Another same interpretation stated by Kasmir (2010, p.24), Islamic banking can be defined as any bank or financial activities with a business line that providing products and services in the form of payment traffic (as one of bank’s functions to serve people) conducted based on Islamic principles.

Basically, Islamic banking will be easily acknowledged by many Islamic banks in the entire world including Indonesia. People will definitely see what financial activities related to the Islamic principles by knowing or being a customer in the Islamic banks. Sudarsono (2008, p.27) defined Islamic banks as a financial institution in which the core business line is to give or provide bank products and services within circulation of money that being operated based on fundamental of Islam.

B. Principles of Islamic Banking
As it has been known in contrast with conventional banks that provide any funds with charged interest and also borrow funds with paid interest, Kettell (2011) Islamic banking has 6 main principles implemented while driving its financial activities:

1. The prohibition of predetermined loan repayments as interest (riba).
2. Risk sharing is put at the core activity of Islamic banks.
3. Making money out of money is unacceptable.
4. Prohibition of speculation behavior.
5. Only Sharia approved contracts are acceptable.
6. The sanctity of contracts.

According to Rivai et al. (2007, p. 759) on his book “Bank and Financial Institution Management: Conventional and Sharia System”, while carrying out their activities, Islamic banks will always adopt main principles of Islam as follow:

a) Principle of Justice: The principle reflects in the implementation of rewarding on the basis of profit-sharing which has been mutually agreed between the bank and its customers.

b) Principle of Partnership: Islamic banks put depositors, funds users and banks on an equal footing and are equal as business partners.

c) Principle of Serenity: Products of Islamic banks are always in accordance with the principles and rules of Islam. There is no presence of riba (usury) element and the products always apply zakat application thus customers will feel the peace and unseen.

d) Principle of Transparency: Through an open financial statements of the banks on an ongoing basis, the customer can determine the level of security of funds and the quality of bank management itself.

e) Principle of Universality: In supporting their operations, Islamic banks do not discriminate against race, religion, race and even religious groups in society like the principle of Islam "rakhmatan lil ' alamin".

f) No usury (non-usurious).

g) A reasonable profit (legitimate profit).
Therefore, the operations of Islamic banks are well-known summarized following the rules of Islam:

1. Free of interest (Riba);
2. Free from speculative activities such as non-productive gambling (Maysir);
3. Free from the things that are not obvious and detrimental (Gharar);
4. Free from things that are broken or invalid (Bathil); and
5. Giving funds for lawful operations only.

The first four rules above are often called as the MAGHRIB which stands for Maysir, Gharar, Riba and Bathil.

(I) Riba (Usury)

Islamic banks do not operate their activities based on interest concept. Riba (usury) means ‘addition’. It is the payment of premium to be paid by the borrower to the lender besides the principal of the loan. This definition is particularly the same as the term of interest happening among conventional banks. According to Yusul a-Qardawi, there are four reasons why riba (usury) is prohibited in Islamic banking practices:

a. Taking interest implies taking another person’s property without giving anything in exchange. The lender receives
something for nothing.
b. Dependence on interest discourages people from working to earn money. Money lent at interest will not be used in industry, trade or commerce, all of which need capital, thus depriving society of benefits.
c. Permitting the taking of interest discourages people from doing good things. If interest is prohibited, people will
lend to each other with goodwill expecting nothing more back then they have loaned.

d. The lender is likely to be wealthy and the borrower poor. The poor will be exploited by the wealthy through the charging of the interest of loans.

In addition, the following table will help to classify and differ between interest and profit-sharing concept:

Table 2.1: Differences between Interest and Profit Sharing

<table>
<thead>
<tr>
<th>Interest</th>
<th>Profit-sharing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Determination of interest is decided at the time the contract was made with the assumption that the business will always make a profit.</td>
<td>Determination of the ratio/profit sharing ratio will be set up at the time the contract was made based on the likelihood of profit and loss.</td>
</tr>
<tr>
<td>The percentage amount is based on the amount of funds or capital borrowed.</td>
<td>The level of risk for the profit sharing is based on the amount of profits earned.</td>
</tr>
</tbody>
</table>
The interest rate will be variable or floated and up-and-down condition is according to the rise and fall of economic condition.

Profit sharing ratio will remain unchanged during the contract is still valid, unless modified by mutual agreement.
Fixed interest payments are running as promised without any consideration of whether the borrower's business carried on profit or loss.

The profit sharing amount will depend on business profits resulted. If the business gets loss, loss will be shared together.

The amount of interest payments will not increase thought the profits are doubled up. The amount of profit distribution will be increased with the increase in profits.

The existence of interest is doubted by all religions. There is no doubt for the validity of the profit sharing.

Source: Rivai et al, 2007, p. 764

(II) Maysir

Maysir is defined as an action in which obtaining something very easily without any hard work or getting benefits without taking efforts. In the Islamic concept, these are all things that contain elements of gambling, betting or risky game.

(III) Gharar

Gharar means a result, disaster, danger, risk, and so forth. In the science of Islam, gharar is all economic transactions that involve an element of
ambiguity, fraud or crime.

There are two concepts of gharar:
a. Gharar happens because of the probability for an element of risk and uncertainty the dominant.
b. Gharar happens because of the element that is associated with fraud or crime by one party to the other party.

(IV) Bathil

Bathil means a partnership agreement to earn an income, but the contracted goods are not in accordance with Islamic principles. For example, Islamic banks should not finance portfolio to finance narcotics as an illicit goods.

C. Islamic Banking and Finance Products

However, Islamic banking provides different products from conventional banking due to the prohibitions on interest, gambling, uncertainty and short selling. To generate wealth is not by making money with money. Schoon (2010, p.25) stated that there always had to be an underlying asset or enterprise that requires financing.

In another wide explanation, Arifin (2009, p.22) completely explained that Islamic banking has its own products and services based on Islamic principles and laws. The main products and services terms of Islamic banking are described below:

1. Profit and Loss Sharing

   There are two types of this contract scheme;
Musyarakah (joint venture profit sharing) and Mudharabah (trustee profit sharing).

a. Musyarakah (joint venture profit sharing)

Two or more parties (banks, financial institutions and customers) can collect their capital to form a corporation (syirkah al inan) as a legal entity. Each party has a
proportional portion according to their capital contribution and each of them has the supervision right (voting right) to supervise the company in accordance with its portion. For profit sharing, each party receives the profits in proportion to their respective capital contributions, or in accordance with a predetermined agreement. When companies lose money, the loss will also be charged in proportion to the respective financiers.

Looking at the implementation in banking sector, it is specified in the business or project in which banks fund a part of the amount of investment or working capital. The rest of it is financed by the customers themselves. This contract is also applied to syndicated interbank or financial institutions.

In the contract, either party may take over the capital of the other party receive their capital back incrementally. This is called Musharaka al mutanaqishah. It happens when the project financing done by banks with their customers or banks with other financial institutions, where part of the bank or financial institution is taken over by the other party by installments.
Figure 2.1: Simple Musharaka Transaction

Source: Schoon, 2010, p. 29
b. Mudharabah (trustee profit sharing)

This is a form of equity financing but possessed different forms of Musharakah. Mudharabah is not a contractual relationship between the financiers but between capital fund providers (shahibul maal) and entrepreneurs (mudharib). On this contract, a mudharib (individual, household enterprises, or economic unit) raise capital from other economic units for the purpose of trade. Mudharib will be a trustee over the capital in this contract.

If the project is completed, mudharib will return the capital to the capital provider along with the portion of a pre-agreed profit. In the event of loss, then the entire loss will be incurred by shahibul maal. Meanwhile, mudharib will have loss of profit (reward-sharing) for the work had done. There are two types of mudharabah:

a. Mudharabah Mutlaqah: The owner of the funds provides full flexibility to managers to use these funds in a good aim and profitable.

b. Mudharabah Muqayyadah: The owner of the funds determines the terms and restrictions in the use of the fund to managers for a period of time, place, types of
businesses and others. Managers use the capital with the goal specifically is to make a profit.
2. Sharia Trading (Al Bai’)

Interest practice is not in accordance with the spirit of Islam is clearly based on the phrase "...God justifies the sale and prohibits usury..". Buying and selling (al bai’) has the meaning that generally includes all types of contracts unless the contract that prohibited by sharia principles.

The understanding about trading agreement includes an exchange contract between a variety of goods and services within a certain amount of goods and other services. Delivery of quantity or price of goods and services can be done immediately (cash and carry) or deferred one. Therefore, to meet debt financing is also included various types of contracts involving the deferred contract of exchange.

Initially, contract means the bond, agreed
engagement, treaty or agreement. Each contract must meet the essential elements as follow:

a. Sighat (ijab-wabul): Ijab means a statement for making the bond and qabul means a declaration of accepting the bond.
b. Muta’aqidaani: All parties who is related to the contract.
c. Ma’qud fiih: The object of the contract

**Prior to bonding, each party may submit as long as the terms are acceptable by common sense.**

**Type of buying and selling (trading):**

a. Bai’ al Mutlaqah: Exchange between the goods or services with cash.
b. Bai’ al Muqayyadah: Exchange occurs between the goods with goods.
c. Bai’ al Sharf: Exchange between the foreign currency to another foreign currency, it can be either bank notes or telegraphic/mail transfer.
d. Bai’ al Murabahah: Exchange with certain goods where the seller should inform clearly what the goods sold and not included as prohibited goods based on Islam point of view.

e. Bai’ al Musawamah: Exchange when the sellers do not tell cost of goods sold and the profit.
f. Bai’ al Muwadha’ah: Exchange where sellers sell at a price lower than the market price (discount).
g. Bai’ as Salam: Exchange where buyers pay for the price of the goods mentioned as the specifications and will be delivered on the agreed date.
h. Bai’ al Istishna’: Exchanges where the price of the goods paid first but can be repaid on schedule and terms.

3. Sharia Lease and Hire-purchase (Ijarah and Ijarah Wa Iqtina’)

This is considered as a model of financing that is justified by Islamic sharia. These models are conventionally known as operating lease and financing lease. This is a contract that involves an item (as prices) with the services or benefits over other goods. Tenants may also be given the option to have the leased goods at the time the lease contract is completed and it's called as al ijarah wa iqtina’ or al ijarah muntahiyah bi tamlik where the lease agreement that occurs between banks (the owner of the goods) to the customer (lessee) with the lease payments are included principal installment.

**Figure 2.4: Operating Lease**

<table>
<thead>
<tr>
<th>1. Provide asset</th>
<th>Lessor</th>
<th>2. Pay periodic rentals</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. Return asset</td>
<td></td>
<td>Lessee</td>
</tr>
</tbody>
</table>

Source: Schoon, 2010, p. 33

**Figure 2.5: Finance Lease**
Source: Schoon, 2010, p. 34
4. Qard

The contract means when this property is lent to others without expecting anything in return. In the literature, Qard is categorized as aqd tathawwu’. This is mutual aid agreement and not a commercial transaction.

In order to realize the social responsibility, Islamic banks may provide facilities called al qard al hasan which means the provision of loans to the parties who should get it. In sharia way, borrower pays back only the principal even though sharia allows the borrower to give the benefits in accordance with the bank's sincerity but completely forbidden to ask for any compensation.

Banks can also use this contract as a complementary product to facilitate customers who need immediate bailout for a very short period of time.

5. Sharia Deposit (Al Wadi’ah)

Wadi’ah is something that is not placed on the owner to be maintained. The goods that are entrusted to be left with called ida’, the one who entrusts called mudi’ and the one who accepts the entrusted goods called wadi’. Thus, Wadi’ah is
merely an agreement between the owner of the goods (mudi’) entrusted to the recipient (wadi’) to keep the property/capital out of damage or loss and also for the security of property. There are two types of wadi’ah:

a. Wadi’ah yad amanah: This is an agreement in which the custodian is the trustee. It means he/she is not required to indemnify the risk of loss or damage that occurs in the entrusted assets unless it happens because the result of
negligence or carelessness from custodian or when the status of the assets turns into wadi’ah yad dhamanah.

On this principle, entrusted assets of each asset owner should be separated and should not be used and the custodian is not entitled to take advantage of the assets. Status of the custodian will be changed in the event of one of two things; the deposit has been mixed and/or the custodians use the entrusted treasury. Wadi’ah yad amanah can be seen in the practice in custody of securities services.

b. Wadi’ah Yad Dhamanah: This is a contract of deposit where the custodian is not only as a trustee but also security guarantor at the same time. The custodians are fully responsible for any loss or damage caused to the asset custodian so they obtain permission from the owner to use the property for commercial property. The owner at any time can withdraw some or all of their possessions. Therefore, they require collateral deposits paid back over them.

All profits generated from the use of such property for the status as deposit becomes custodian’s right. But, the custodian is allowed to give a bonus to property owner of its own volition without bound by the agreement.
6. Rahn

According to sharia way, Rahn is an action to hold something in a way that justified that allows it to be withdrawn. That makes goods which have value in the eyes of sharia as collateral for the debt so the person should take all of the debt.
or half of it. In other words, Rahn is a contract of pawn the goods from one party to another with debt instead.

Rahn is categorized as tabaru’ transaction in which what is given by Rahin (owner of the goods) to murtahin (holder of the goods) will be something not on benefits. In banking operation, this contract may be used in addition to financing risk and require additional collateral. This agreement can also be products to serve the needs of customers in the purpose of service and consumptive such as education, health and so on. Banks or other financial institutions do not draw any benefit unless the cost of maintenance or security of the mortgaged goods.

7. Wakalah

This is an agreement between the representatives between two parties where the first party gives the representation for any affair to the second party to act on behalf of the first party. There are three types of wakalah:

a. Wakalah al Mutlaqah: Absolutely representing without time limit and intended for all affairs.

b. Wakalah al Muqayyadah: Appointment of a representative to act on its behalf in certain matters.

c. Wakalah al Ammah: A broader representation rather than
al muwayyadah but simpler than al mutlaqah.

Usually, this is applied for the issue of Letter of Credit (L/C) or demand for domestic goods from overseas banks (export L/C). Wakalah is also applied for the transfer of customer funds to other parties.
8. Kafalah

According to the Hanafi, it is the responsibility of a person to enter into the responsibility of another person in a public demands. In other words, kafalah makes a person partly responsible for someone else's responsibility with regard to the lives matter, debt or goods. Nevertheless, the guarantor which is partly responsible will not be considered a debt owed and the debt of guaranteed party does not fall with guarantee of the guarantor.

According to the Maliki, Shafi'i and Hanbali, this is to make the guarantor partly responsible for one's responsibilities in the redemption or repayment of debt and thus both are deemed owed. In financial institutions, this agreement is seen in the issuance of bank guarantees. There are three types of Kafalah:

b. Kafalah bil Maal: Guarantee of a debt payment or debt settlement can be shaped as an advance payment bond or payment bond.
c. Kafalah Muallaqah: Absolute guarantee that is restricted by a certain time and for a particular purpose, for example, to guarantee the implementation of the project (performance bonds) or the bid security (bid bonds).
9. Hawalah

This is a transfer of debt or receivables contract one party to another party. In this case, there are three parties, namely those who owe (muhil or madin), those who give (muhal or
da’in) and those who receive debt removal (muhal ‘alaih). According to Hanafi, there are two types of hawalah:

a. Hawalah Mutlaqah: Someone moves the debt to someone else and does not associate with the existing debt on the person.
b. Hawalah Muqayyadah: Someone moves the debt and hooks up with her existing accounts receivable.

Indeed, most of scholars do not allow benefit (reward) for the removal of the debt or receivables.

10. Ju’alah

This is a contract whereby the first party promises certain benefits to both parties on the implementation of a task or service performed by the second party to the first party interests. This principle was applied in offering a wide range of services to take a fee from the customer (bank references, business and other information).

11. Sharf

This is an exchange transaction between silver or gold with foreign currency exchange foreign currency which is exchanged for domestic currency or in foreign currency. Islamic banks apply these principles to the record must meet the following conditions:
a. It should be a cash
b. The handover should occur within the contact assemblies
c. If it is exchanged with the same currency should be at the same amount/quantity.
D. Islamic Banking in Indonesia

The first real evidence of Islamic banking operations in Indonesia started in the 1990s when Bank Muamalat Indonesia (BMI) was established in 1992. Utama (2006) stated that the development of Islamic banking in Indonesia was firstly started by Bank Muamalat Indonesia which faced alone in the competition in the 1990s. The numbers of Islamic banks in Indonesia rapidly increased around 2000. Based on a data taken from Bank of Indonesia, in 2004, Islamic banks had reached IDR 14 trillion contributing in Indonesia’s banking sector.

In promoting Islamic banking and finance, the government Indonesia has been struggling to help the rate of success on this banking system by doing lots of things. In his study, Ahmad (2009, p. 235) mentioned that in 1994, the Bait al-Maal wa at-Tamwil (BMT) was launched by the government to be prepared as national movement for Islamic development issue. BMT focuses its target market on petty traders and hawkers. Other than that, government also got helped by the Union of Muslim Indonesian Intellectuals (ICMI) to create a managerial project, PT Manajemen Musyarakah Indonesia (MMI) that provides an institutional liaison between small enterprises and investors who absolutely want to develop Muslim enterprise. MMI also creates
“People’s Shariah Credit Banks” which sets up savings and credit arrangements by implementing profit sharing.

Ahmad (2009, p.237) also mentioned that a “blueprint” for Islamic banking was issued by Bank of Indonesia in September 2002. The blueprint was about to forecast growth of Islamic banking that this sector would reach 5% of total banking asset by 2011. In addition, Islamic banking can be a threat for conventional banking seen by the declaration in the report released in March 2005 from Bank of
Indonesia in which Islamic banking is poised to expand more than two-thirds starting in 2005. Conventional banks would be better to have more program attracting customers to come. But, anticipating this case, several conventional banks see the existence of Islamic banks is an inspiration to also create or combine their system with Islamic ways. In 2009, there were seven Sharia units developed by conventional banks. Even more, foreign banks like ABN Amro and Standard Chartered Bank are planning to develop Sharia units. (Ahmad, 2009)

2.1.3 Differences between Islamic and Conventional Banking

Indeed, both Islamic and conventional banking will certainly have several essential characteristics that make those kinds of banking system different. According to Jamaldeen (2012) in his book Islamic Finance for Dummies, the differences between Islamic and conventional banking can be analyzed in four ways:

1. The Oversight of Islamic/Sharia Board

Islamic banks always have a sharia board to ensure their bank operations are complied with sharia principles. It is a must since the main basic difference between Islamic and conventional banking is interest. Thus, sharia board has responsibility to supervise Islamic banks for following four core principles:

a. Usury (riba’) Prohibition
b. Speculation Avoidance
c. Gambling Avoidance

d. Ethical Investment

2. Concepts of Money and the Basis of Transactions

   Basically, conventional banks will do their business activities based on country’s financial laws and regulations (Indonesia Banking Laws: the Laws No. 10, 1998) while Islamic banks perform their financial services based on Islamic business law or called as *fiqh-u-muamalat*. 
In this point of view, Islamic banks will interpret money is not commodity but a tool or medium that can be used by their clients to exchange each other.

3. Relationships with Clients/Customers

It is quite different in the customer relationship scheme. Conventional banks will have a relationship with customers only as creditors-debtors where the banks have responsibility to pay (deposits) or get (loans) back with or without any interest based on the contract between banks and customers. On the other hand, Islamic banks will have no such debtors-creditors relationship in doing their business services with customers. In Islamic banks, there is only partnership model with all of their customers.

4. Investments in the Bank

In Islamic banks, customers must be really aware of the financial tracking of the banks because in the concept of investments Islamic banks will not guarantee the principles and returns of customers that have been invested (as deposit also) to the bank. If someday Islamic bank is loss in money or bankruptcy, the bank is not liable to pay the money to the customers. Differently, conventional banks will surely guarantee principal and even the returns to customers in case of expired contracts or even when the bank loses the money in an investment.
Below is the research summary that had been worked by Rivai and friends to find the differences between Islamic and conventional banking. There are several parameters that identify how both banking systems differ.
Table 2.2: Differences between Islamic and Conventional Banking

<table>
<thead>
<tr>
<th>PARAMETERS</th>
<th>CONVENTIONAL BANKING</th>
<th>ISLAMIC BANKING</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal Basis</td>
<td>Banking laws</td>
<td>Banking laws and Islamic/sharia principles</td>
</tr>
<tr>
<td>Return</td>
<td>Interest, commission fee</td>
<td>Profit sharing, rental income margin, commission fee</td>
</tr>
<tr>
<td>Customer Relationship</td>
<td>Debtors and creditors</td>
<td>Partnership, investors, investors entrepreneurs</td>
</tr>
<tr>
<td>Function, Activity</td>
<td>Non anti riba’ and non anti maysir</td>
<td>Anti riba’ and anti maysir</td>
</tr>
<tr>
<td>Mechanism and Objectives</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operational Basic Principle</td>
<td>- Materialist principle</td>
<td>- Islamic/sharia principle</td>
</tr>
<tr>
<td></td>
<td>- Money as commodity</td>
<td>- Money as medium of exchange (not commodity)</td>
</tr>
<tr>
<td></td>
<td>- Interest</td>
<td>- Profit sharing, buying and selling, rent</td>
</tr>
<tr>
<td>Service Priority</td>
<td>Personal interests</td>
<td>Pint interests</td>
</tr>
<tr>
<td>Orientation</td>
<td>Profitability</td>
<td>Islamic socio-economy, profitability</td>
</tr>
<tr>
<td>Customer Evaluation</td>
<td>Commercial bank</td>
<td>Commercial bank, development bank, universal bank/multi-purposes</td>
</tr>
<tr>
<td>Customer Awareness Level</td>
<td>Creditworthiness and collateral</td>
<td>More aware due to partnership system</td>
</tr>
<tr>
<td>Source of Short-term Liquidity</td>
<td>Limited debtors and creditors</td>
<td>Partnership</td>
</tr>
<tr>
<td>Given Loan</td>
<td>Money market, central bank</td>
<td>Limited</td>
</tr>
<tr>
<td><strong>Business Principle</strong></td>
<td>Commercial and non-commercial, profit-oriented</td>
<td>Commercial and non-commercial, profit-and-non-profit-oriented</td>
</tr>
<tr>
<td>------------------------</td>
<td>-----------------------------------------------</td>
<td>------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Fund Management</strong></td>
<td>Assets to liabilities</td>
<td>Liabilities to assets</td>
</tr>
<tr>
<td><strong>Dispute Settlement</strong></td>
<td>Court, arbitration</td>
<td>Court, National Islamic Arbitration Institution</td>
</tr>
<tr>
<td><strong>Investment Risk</strong></td>
<td>- Bank risk is indirectly related to debtors, debtors risk is indirectly related to the bank</td>
<td>- Facing together between bank and customers with sportsmanship principle</td>
</tr>
<tr>
<td></td>
<td>- Negative spread is possible to happen</td>
<td>- No possibility in negative spread</td>
</tr>
<tr>
<td><strong>Financing Monitoring</strong></td>
<td>Limited in administration</td>
<td>Possibility to interact directly in customer management</td>
</tr>
<tr>
<td><strong>Supervisory Organizational Structure</strong></td>
<td>Board of Commissioners</td>
<td>Board of Commissioners, Board of Islamic/sharia Trustees, Islamic/sharia National Council</td>
</tr>
<tr>
<td><strong>Financial Criteria</strong></td>
<td>Bankable, kosher (halal) or illicit (haram)</td>
<td>Bankable, kosher (halal)</td>
</tr>
</tbody>
</table>

Source: Rivai et al., 2007, p.766

2.1.4 Introduction to Financial Statement & Report

In every business entity, they should have several financial statements and report to overview their financial performance. Wolfe (2013) said that a firm would show how income and expenses have affected the firm as a whole by creating and providing financial statements. Based on the explanation from Baar (2012) in his study about basic of financial statements, these financial statements will be used
by internal people in the business such as managers and employees, and also by external people including vendors, investors and bankers. For additional function, it would
help people who do research and need financial statements as their resources of the research.

Periasamy (2013, p.149) found that financial statements are broadly grouped into two statements – Balance Sheet and Income Statement. To complete and support those statements, there are two following statements that are prepared to meet the needs of the business concern – Statement of Changes in Owner’s Equity and Statement of Cash Flows. He also explained important objectives of financial statements below:

a. To provide adequate information about the source of finance and obligations of the finance firm.
b. To provide reliable information about the financial performance and financial soundness of the concern.
c. To provide sufficient information about results of operations of business over a period of time.
d. To provide useful information about the financial conditions of the business and movement of resources in and out of business.
e. To provide necessary information to enable the users to evaluate the earning performance of resources or managerial performance in forecasting the earning potentials of business.

In terms of financial reporting, International Accounting Standard Board has their statement included in a working paper “Quality of Financial Reporting” written by Beest et al (2009) as follows:

“The primary objective of financial reporting is to provide high-
quality financial information concerning economic entities, primarily financial in nature, useful for economic decision making." (p.3)
Indeed, providing financial reporting information in the best way is quite important because it will positively influence capital providers and other stakeholders in making investment, credit and similar resource allocation decisions. Securities and Exchange Commission (SEC) and Financial Accounting Standard Board (FASB) had same agreement that to involve evaluations of alternative opportunities from comparing and analyzing financial statements and reporting would help in investing and lending decisions (as cited in De Franco, Kothari & Verdi, 2011, p.1). Thus, in the following sections, it will introduce more about three financial statements and annual report to be publicly published by banks that commonly used by people to do the comparative analysis among firms and banks.

1. Annual Report

Basically, annual report refers to an annual publication that public corporations must provide to shareholders to describe their operations and financial conditions. According to Bhana (2009, p.33), the statutory formal communication tool between a public listed company and its interested constituencies is essentially corporate annual report.

International Financial Reporting Standards recommends that the company should at least put the components of annual report below (as cited in Mongiello, 2010, p.12):

a. Chairman’s Letter to the Shareholders
b. Operational Review

c. Director’s report: Business Review

d. Director’s report: Corporate Governance

e. Financial Statements: Income Statement, Balance Sheet,
   **Statement of Cash Flow, Statement of Changes in Equity**

f. Notes to the Accounts

g. Accounting Policies

h. Auditor’s Report
2. Publication Report

According to Leon & Ericson (2007, p.104), all banks’ financing activities will be seen in a complete financial report called Publication Report. In Indonesia, Bank of Indonesia has set up the rules and regulation regarding how the bank should report in public. As Bank of Indonesia Circular No. 12/11/DPNP dated 31 March 2010 that regulates the publication of quarterly financial reports and monthly, each registered bank should prepare publication report every three months (quarter basis) where the months of publication are in March, June, September and December every year. This publication report consists of on-balance sheet, off-balance sheet, income statement, financial ratio calculation and the appendices (Leon & Ericson, 2007).

3. Balance Sheet

Department of Education and Early Childhood Development from State Government Victoria introduced the balance sheet and interpreted it as the financial history of the company at one point in time which is normally the end of fiscal quarter or year of the company itself. The balance sheet must be provided to shareholders to describe their operations and financial conditions. Based on Mongiello (2010, p.15), the balance sheet is also called as the statement of financial position or statement of financial

ASSET = LIABILITIES + EQUITY
condition with the core theory:

According to Jan (2011), the general structure of balance sheet is explained as follow:

a. Assets
   - Current Assets: Cash, Accounts Receivables, Notes Receivables
• Fixed Assets: Land, Buildings, Equipment, Machinery, Vehicle

b. Liabilities and Equity
• Current Liabilities: Accounts Payable, Notes Payable, Accrued Payroll and Withholding
• Long-term Liabilities: Mortgage Note Payable
• Equity: Owner’s Equity, Common Stock, Retained Earnings

4. Income Statement
According to Baskerville (2012), income statement is defined as “Profit & Loss Statement”, “Statement of Financial Performance”, “Revenue Statement”, “Earnings Statement” or “Operating Statement”. The income statement shows the financial performance of a business for a given accounting period. Usually, the periods are in monthly, quarterly and annually basis. This statement summarizes the revenues earned and subtracts the expenses incurred in earning that revenue to calculate the resulting net profit or loss for the business for a given accounting period.

Fakahany (2003, p.24) observed regarding the components of income statement to find out how to recognize the complete income statement provided by any company or bank:

a. Net Sales – Amount of money made from the goods or the services.

b. Cost of Sales – Amount of money until the company to be able to have the goods or services ready.
c. **Gross Margin** – How much money that the company receive compared to what it cost to made the good or service. The value is from Net Sales – Cost of Sales.

d. **Depreciation and Amortization** – Subtraction from the value of asset because of utilize over time.
e. **Selling, General and Administrative Expenses** – Costs involved in getting the product or service ready to sell that are not directly related to the product itself.

f. **Operating Income** – Amount the company has left over after paying its own costs. The value is from Gross Margin – Expenses incurred to operate the business.

g. **Dividend and Interest Income** – Additional money that received from ownership and investments externally.

h. **Interest Expense** – Amount of money that the company needs to pay others because of its borrowing.

i. **Income Tax Expense** – Amount of money that the company will have to pay in taxes as a result of the income applied to the appropriate tax amount.

j. **Income Before Extraordinary Loss** – All income and expenses without any extraordinary items.

k. **Extraordinary Items (Net of Tax)** – Unusual and infrequent items that probably will never happen to the business again (e.g. Earthquake).

l. **Net Income** – Includes all sources of income and all costs. It can be valued in positive or negative numbers.

### 2.1.5 Introduction to Financial Ratios

To find out the financial performance by utilizing financial statement of banks, there will be financial analysis to play the role. As explained by Drake (2008), financial analysis is defined as the selection, evaluation and interpretation of financial data along with other related information. There are many methods to be used for implementing financial analysis and the most common one is calculating by financial ratios. According to Ncube (2009), accounting methods by financial ratios
is usually the use of assessment for bank performance (cited in Kumbirai & Webb, 2010). By financial ratios, somehow it would simplify the process of determining the health of a listed company and
make reported financial information more meaningful and useful for investors.

Jan (2013) who stated that financial ratio analysis would involve calculating certain standardized relationship between any information in the financial statement therefore it would help to analyze bank’s position and financial performance. According to Averkamp (2011), basically ratio expresses a mathematical relationship between two items. Further, if the ratio is expected to be useful comparison, those two items’ value must be related to each other.

There are lots of financial ratios being used in the measurement of financial performance. Below is the explanation of several ratios that represent how the financial position of banks in capital adequacy, profitability and liquidity.

A. Capital Adequacy

Bank of Indonesia has distinguished the regulation of bank’s capital. All banks which are established and headquartered in Indonesia will have capital consisting of core/primary capital and supplementary/secondary capital. Suhardi (2003) restated the regulation on his book regarding the requirement of minimum capital which is standardized under Bank of Indonesia authority.
Bank Indonesia requires each bank providing a minimum capital of 8% of total risk weighted assets (RWA).

(I) Capital Adequacy Ratio (CAR)

The results of CAR calculation is then compared with the minimum capital requirement (which is equal to 8%). CAR is a ratio to measure bank’s capacity to meet its liabilities and risks. The higher CAR value means the healthier the bank to be able covering up its financial with its sufficient
capital. According to Leon & Ericson (2007), below is step-by-step calculation of the capital adequacy of bank:

Step 1 – RWA balance sheet assets is calculated by multiplying the nominal value of each asset with the risk weight of each item of the balance sheet assets.

Step 2 – RWA administrative assets is calculated by multiplying the nominal value of off-balance sheet risks concerned with the weight of each item of the account.

Step 3 – RWA = Total Balance Sheet Assets + RWA Administrative Assets.

Step 4 – The bank's capital ratio is calculated by comparing the bank's capital (core capital + supplementary capital) and total RWA.

Equation 1: CAR

B. Profitability

Ross, Westerfield & Jaffe (2005) expressed that the most difficult element of a bank to evaluate is profitability because it represent whether the bank has enough profit or not. Bank will be very profitable when revenues are exceeded values rather than the
cost (Gul, Irshad & Zaman, 2011). Profits are also important to creditors because profits are one source of funds for debt coverage. Furthermore accountants use profit as a performance measure. According to ICAP Group as South Eastern Europe business service group, analysis of profit is a vital concern to stockholders since they derive revenue in the form of dividends therefore profitability ratios are designed to evaluate the firm's ability to generate earnings such as Return on Assets (ROA),
Return on Equity (ROE), Net Interest Margin and Operating Efficiency Ratio (OER).

(I) Return on Assets (ROA)
Van Horne explained that Return on Assets (ROA) indicates the profitability on the assets of the firm after all expenses and taxes (as cited in Moin, 2008, p.22). This ratio also reflects the ability of management to acquire deposits at a reasonable cost and invest the deposits in profitable investments (Ahmad, 2009). According to Kader et al. (2007), a higher ratio means that efficient management of the bank is utilizing assets effectively.

Equation 2: ROA

(II) Return on Equity (ROE)
It is defined as a measurement tool for the shareholders to evaluate percentage return on each rupiah of equity invested in the bank’s stock. Based on Rivai et al. (2012, p.490), the ratio shows bank’s ability in terms of managing its equity for generating the profit after taxes. According to Ross, Westerfield & Jaffe (2005), better managerial performance is reflected by
higher ROE but somehow a higher ROE may be due to debt (financial leverage) or higher ROA as long as the ROA is greater the interest rate on debt.

Equation 3: ROE
(III) Operating Efficiency Ratio (OER)

Operating efficiency ratio (OER) or operating expenses to operating income is often called as the efficiency ratio used to measure the ability of bank management to control operating expenses to operating income. According to Hariyani & Toruan (2010, p.54) explanation on their book, the ratio will be interpreted that the smaller the ratio the more efficient operating costs incurred which is concerned that the possibility of a bank in error gets smaller. The OER is calculated from operating costs (total sum of interest expense and total other operating expenses) and also operational income (sum of total interest income and total other operating income).

Equation 4: OER

\[ \text{OER} = \frac{\text{Operating Costs}}{\text{Operational Income}} \]

C. Liquidity

Liquidity of a firm including bank is somehow really crucial because liquidity will indicate the ability of the bank to meet its financial obligations in a perfect timing and effective manner especially for commercial banks. As stated by Samad (2004, p.36), whatever it is the liquidity is still the one which becomes life and blood of commercial bank.
Liquidity is merely a measure of the quality and adequacy of current assets to meet current obligations so implicitly liquidity figures out whether the bank can quickly convert the assets to cash for meeting the short-term obligations. The assets that might be converted to cash form, it is called as Liquid Asset (Drake, 2008). Rafiuddin & Alam (2012, p.74) explained that to choose a greater liquidity bank is looked at
the higher amount of liquid asset for a bank thus the failure of bank to meet its obligations will highly have poor credit worthiness which can affect to be loss of creditors and confidence. Therefore, there are many ratios to be used for evaluating the liquidity level of a bank or company. Loan to Deposit Ratio (LDR) or Financing to Deposit Ratio (FDR) is a liquidity ratio that will be use in the financial performance evaluation during the study.

(I) **Loan to Deposit Ratio (LDR)/Financing to Deposit Ratio (FDR)**

LDR or FDR are commonly used to evaluate bank or company’s financial health in liquidity aspect where LDR is used in conventional banks and FDR is calculated in Islamic banks’ financial report. Based on Suhartatik & Kusumaningtias (2013), Islamic banking named it FDR because there are different elements to be calculated while conventional bank calculates loans, Islamic calculates all financing given. However, the function is perfectly same. Both ratios are quite critical to be thinking of because the bank must control theirs capacity for issuing deposits or loans. The lower LDR/FDR bank will have is considered to have excessive liquidity, potentially lower profits and less risk to be compared with other banks which have higher LDR/FDR. But,
higher LDR/FDR will show the stress taken up by the bank by offering excessive loans. Somehow, according to SNL Finance’s study as cited in an article by Cole (2012), stated that a stronger LDR may also strengthen the net interest margin of a bank.
All of those financial ratios will be evaluated by Bank of Indonesia where this central bank set up minimum requirement for the financial ratios. Table 2.3 briefly shows the minimum requirement of financial ratios above (CAR, ROA, ROE, OER and LDR) is regulated on Bank of Indonesia Circular No. 6/23/DPNP dated May 31, 2004 in the part of Rank Designation Matrix.
2.2 Previous Research

Table 2.4: Previous Researches

<table>
<thead>
<tr>
<th>RESEARCH TITLE</th>
<th>YEAR</th>
<th>RESEARCHER NAME</th>
<th>INDEPENDENT VARIABLES</th>
<th>RESEARCH HIGHLIGHT</th>
<th>RESEARCH RESULT</th>
</tr>
</thead>
</table>
| Do Islamic Banks Perform Better than Conventional Banks? Evidence from Gulf Cooperation Council Countries | 2006 | Hadeel Abu Loghod    | a. Profitability Ratios  
b. Liquidity Ratios  
c. Structural Ratios | Summary: Analyzing financial performance taken from dataset that covers 6 years from 2000 to 2005 and contains 342 semi annual observations overall; (69) observation for major Islamic banks and (273) observations for conventional banks in The Gulf Cooperation Council Countries (GCC) included Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and Arab Emirates. | a. Islamic banks had a significantly higher Cash-to-Asset Ratio and Cash to deposits Ratio when compared to conventional banks.  
b. Islamic banks have higher average ratios of LAR, LDR and LER in the selected GCC countries than the conventional banks.                                                                 |


b. Asset/Liabilities Ratios  
c. Profitability Ratios. | **Data Methodology:**  
Independent Sample T-Test, test for equality and advanced binary response model and a Logit model (master degree level).  
c. Islamic banks in Bahrain, Saudi Arabia had a higher Equity-to-Asset Ratio.  
d. Islamic banks have significantly higher average of Fixed Asset-to-Asset Ratio than Conventional banks in all selected GCC countries.  

| **Summary:**  
Analyzing financial performance of 1 Islamic bank and 6 conventional banks that are qualified by two conditions;  
1) The banks are Kuwaiti banks, non-foreign banks;  
2) The banks provide last four | **The hypothesis was rejected as the overall significance is < 0.05 which indicated that two groups of banks in Kuwait during 2004 – 2007 did not have any significant different in their financial performance.** |
### Performance of Islamic Banking and Conventional Banking in Pakistan

<table>
<thead>
<tr>
<th>Year</th>
<th>Author</th>
<th>Methodology</th>
<th>Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>Muhammad Shehzad Moin</td>
<td>Independent Sample T-Test, Purposive Sampling</td>
<td>Analyzing financial performance of Islamic and conventional banking in Pakistan especially Meezan Bank Ltd as Islamic bank and 5 conventional banks during 2003 – 2007. The conventional banks are more profitable and different from Islamic banks in ROE as ROE is found rising for Islamic banking during 2003 – 2007 due to the difference in equity base and profit level. In liquidity measures, LDR and Loan-to-Asset Ratio (LAR) of two groups of banks showed that Islamic bank</td>
</tr>
</tbody>
</table>
liquidity is not different from conventional banks but conventional banks were more liquid in terms of Cash & Portfolio Investments to Deposits & Borrowings.
c. In the solvency measures, conventional banks were more risky and less solvent than Islamic banks.

b. Return on Equity  
c. Loan to Deposit Ratio  
d. Return on Assets | Summary: Analyzing financial performance of 8 conventional banks and 2 Islamic banks that are registered in Bank of Indonesia by gathering secondary data (annual report) from all the banks during a. Islamic and conventional banking are significant different seen from CAR value with significance of t-value 0.000 (lower than 0.05)  
b. Islamic and conventional banking did not differ |
b. Non Performing Loan  
c. Loan-to-Deposit Ratio | Summary:  
Analyzing financial performance of PT. Bank Syariah Mandiri and PT. Bank Muamalat Indonesia (represent Islamic banking), PT. Bank Negara Indonesia, PT. Bank Mandiri, | The probability of t-value of OER > 0.05 thus they are not significantly different in OER.  
Data Methodology:  
Independent Sample T-Test, Purposive Sampling  
c. The value of T-test 0.702 < 2408 with the significant probability of 0.489 > α 0.05 thus the means of overall performance for Islamic and conventional banking were significantly different. |
### Summary:
Analyzing financial performance of 2 Islamic banks and 4 conventional banks in the period of 2006 – 2010 with the criteria 1) Islamic banks that have been exist at least 5 years and provide

<table>
<thead>
<tr>
<th>Capital Adequacy Ratio</th>
<th>Non Performing Loan</th>
<th>Loan-to-Deposit Ratio</th>
<th>Operating Efficiency Ratio</th>
<th>Return on Assets</th>
</tr>
</thead>
</table>

- a. Capital Adequacy Ratio
- b. Non Performing Loan
- c. Loan-to-Deposit Ratio
- d. Operating Efficiency Ratio
- e. Return on Assets

<table>
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<tr>
<th>2012</th>
<th>Widya Wahyu Ningsih</th>
</tr>
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</table>

PT. Bank Rakyat Indonesia, and PT. Bank Tabungan Negara (represent conventional banking) during 2002-2011.

**Data Methodology:**
Independent Sample T-Test, Purposive Sampling

- a. CAR of Islamic banks is higher and different from conventional banks (eligible in above 8%)
- LDR mean of Islamic banks is higher than conventional banks (eligible in 85 – 110%).
<p>| | | | | |</p>
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<tr>
<td>d. Operating Efficiency Ratio</td>
<td>the financial report to public from December 31, 2006 to December 31, 2010; 2) Conventional banks that have Islamic banking unit/branch and provide the financial report to public from December 31, 2006 to December 31, 2010.</td>
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<tr>
<td>e. Return on Assets</td>
<td>Data Methodology: Independent Sample T-Test, Purposive Sampling</td>
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<td></td>
<td>b. NPL mean of Islamic banks is lower and different from conventional banks (not eligible in under 5%).</td>
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<td>c. OER mean of Islamic banks is lower and different from conventional banks.</td>
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<td></td>
<td>d. ROA mean of Islamic banks is higher and different from Islamic banks (eligible in &gt; 1.5%).</td>
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<tr>
<td></td>
<td>There is a significant difference between Islamic and Conventional banking.</td>
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</table>
Analisis Perbandingan Kinerja Keuangan Bank Umum Syariah dan Bank Umum Konvensional serta Pengaruhnya terhadap Keputusan Investasi

Liviawati and Rita Wiyati

Summary:
Analyzing financial performance of Islamic banking and conventional banking in the period of 2003 – 2004

Data Methodology:
Independent Sample T-Test, Purposive Sampling, Linear Regression

| a. Capital Adequacy Ratio |
| b. Non Performing Loan |
| c. Loan-to-Deposit Ratio |
| d. Operating Efficiency Ratio |
| e. Return on Assets |
| f. Return on Equity |

a. Islamic and conventional banking are significant different seen from CAR value with significance of t-value 0.014 (lower than 0.05)
b. Islamic and conventional banking are significant different seen from NPL value with significance of t-value 0.018 (lower than 0.05)
c. Islamic and conventional banking are significant different seen from ROA value with significance of t-value 0.026 (lower than 0.05)
d. Islamic and conventional banking are significant different seen from OER value
with significance of t-value 0.043 (lower than 0.05)
e. Islamic and conventional banking are significant different seen from LDR value with significance of t-value 0.024 (lower than 0.05)
f. Islamic and conventional banking are significant different seen from ROE value with significance of t-value 0.045 (lower than 0.05)
g. Investment decision is influenced by financial performance both Islamic and conventional banking
2.3 Theoretical Framework

This research is aimed to analyze comparative financial performance between Islamic and conventional banking in which there must be several indicators to indicate and assess the differences in financial performance. As stated by Casu et al, 2006), to evaluate and analyze bank’s performance every bank regulators measure it by using financial ratios to be the indicators or parameters.

According to Ali & Rami (2006) as cited in Moin (2008), to measure financial performance of banks commonly uses financial ratios even most of bank regulators use the ratios to evaluate bank’s performance. Capital adequacy is defined as an important proxy to evaluate whether the bank is health or not. Based on the explanation of Lessambo (2013), the creation of risks in the bank will be occurred if the bank has inadequacy capital. Therefore, capital adequacy ratio is determined to be very useful and meaningful to evaluate bank’s ability in capital adequacy. Capital Adequacy Ratio (CAR) will be one of independent variable to evaluate financial performance between Islamic and conventional banking in this research.

As stated by a college professor of Business Finance, Peavler (2010), profitability ratios are quite important to be used in evaluating bank’s performance because the ratios measure different aspects of profitability itself. Some main questions such as “how good is a bank running its activities?”, “how
profitable is it compared with other banks” and “does the performance meet the standard?” can be answered by analyzing profitability ratios. Thus, the researcher will use three ratios as independent variables to identify the health of Islamic and conventional bank in this research Return on Asset (ROA), Return on Equity (ROE) and Operating Efficiency Ratio (OER).
Besides that, profitability ratios will only cover the profitability aspects in financial performance. Another component that would be also important to be analyzed is liquidity ratio. For banks, evaluating liquidity is the most critical one because it is related to the credit activities. Based on a journal about the importance of liquidity ratios, Prof. Dr. Silvia Petrescu, the author of the book “The Financial – Accounting Analysis and Diagnosis, 2nd Edition”, the ability of companies or banks to face the short term obligations can be definitely measured by liquidity ratios. Liquidity of the bank will also reflect the capacity of current assets-to-cash transformation. Therefore, liquidity ratio is considered as a core tool to evaluate financial performance for any financial institutions and Loan-to-Deposit Ratio (LDR) will be observed as an independent variable in terms of liquidity aspect.

At last, all of those explanations can be summarized that capital adequacy, profitability and liquidity have been important indicators for evaluating and analyzing bank’s financial performance. It would help to find out how Islamic and conventional differ from each other in terms of their financial performance. In below illustration, Figure 2.6, it reflects the core theory of this research.

Figure 2.6 Theoritical Framework
Source: Puspitaningrum & Triyuwono, 2007
2.4 Hypothesis

The researcher adopts hypothesis for this research as follow:

H₁: There is significant difference in financial performance between Islamic and conventional banks based on CAR.

H₂: There is significant difference in financial performance between Islamic and conventional banks based on ROA.

H₃: There is significant difference in financial performance between Islamic and conventional banks based on ROE.

H₄: There is significant difference in financial performance between Islamic and conventional banks based on OER.

H₅: There is significant difference in financial performance between Islamic and conventional banks based on LDR.
3.1 Research Design

Every research will have their own objectives, and to achieve the objectives, the research should determine what research design that can be applied the best. Based on Crotty’s model, research design is defined as a conceptualization made by the researcher by analyzing three elements; knowledge claims, strategies and methods (Cresswell, 2003). Those three elements reflect three questions that will lead into what the exact research design should be used in the research, the questions are mentioned below:

1. What knowledge claims are being made by the researcher (including a theoretical perspective)?
2. What strategies of inquiry will inform the procedures?
3. What methods of data collection and analysis will be used?

This research focuses on banking sector analysis where it puts comparative analysis between banks in terms of their financial performance using several ratios to examine which one can be considered as a good type of bank in the current time. The research will widely introduce numbers and statistics. Therefore, this research applies quantitative research which is described by Aliaga and Gunderson (cited in Muijs, 2010) that the research is ultimately explaining phenomena by collecting numerical data that are analyzed
using mathematically based on methods (in statistics concept). According to Ernst (2003), usually quantitative research uses data consisting of standard measurement, surveys and any kind of source that provides rough and numeric information. He also stated that using
quantitative one as research design is better to use more information given or larger samples.

3.2 Sampling Design

In this research, the population used is banking sector which is more precisely 2 chosen Islamic banks and 2 chosen conventional banks listed as original banks of Indonesia. The method used in the determination of the sampling is Purposive Sampling method which is known as a non-probability form of sampling. Purposive sampling is aimed to seek samples/participants in a strategic way instead of a random basis. This sampling method’s objective is to find that the samples are relevant to the research questions that are being posed. Criteria for the selection of the sample to be examined in this study are explained as follows:

1. The chosen Islamic banks are registered and listed in Bank of Indonesia where the banks provide quarterly publication report from Quarter 1 in 2006 to Quarter 3 in 2013.

2. The chosen conventional banks are registered and listed in Bank of Indonesia as state owned banks of Indonesia where provide quarterly financial publication report from Quarter 1 in 2006 to Quarter 3 in 2013.

3. Both Islamic and conventional banks should be in the same level to compare therefore the chosen banks are the ones which have reached profit between 1,000,000 – 10,000,000 (in million rupiahs) in 2012.

Based on all criteria above, 4 banks are obtained since they
meet the sample criteria for this research which are a) 2 Islamic banks (PT Bank Syariah Mandiri and PT Bank Muamalat Indonesia), and b) 2 conventional banks (PT Bank Tabungan Negara and PT Bank Negara Indonesia).
3.3 Research Instruments

3.3.1 Data Sources

Type of data that used for this research is categorized as secondary data. The data is taken from Bank of Indonesia’s library on its official site and also from the website of the banks concerned. All the secondary data is the audited financial statements which combination data of inter-banking companies (cross section) between Islamic and conventional banks. The collection of financial data has time frame in the period of 2006 – 2013 (called as Polling Data). The data that needed in this research is Quarter Financial Publication Report from January 2006 to September 2013 that has contents of Balance Sheet, Income Statement and Financial Ratios Calculation. Other supporting sources are related articles and several reports published by Bank of Indonesia.

3.3.2 Conceptual Definitions

As this quantitative research is performed within the context of a theoretical framework in the previous chapter, there is a conceptual rationale and a clear vision of the concepts. Based on an explanation from Polit & Beck (2013, p.52), a conceptual definition informs about the abstract or any theoretical meaning of a concept that would be measured by the variables of research. In this research, there are four points that will be described as conceptual definitions:
a) Quarter Financial Publication Report

As per Bank of Indonesia Regulation No. 31/40/KEP/DIR and No. 31/176/KEP/DIR (cited in Suhardi, 2003), this report is an interim financial statements and a compulsory report that should be published in every year with quarterly basis consisting of balance sheet, income statements, statement of commitments and contingent, financial ratios calculation and other information posted.
b) Income Statement

John N. Myer stated that income statement is included in the financial statements in which shows the result of operations during a certain period (cited in Kesavan et al., 2005). Income statement describes revenues, operational expenses and also any profit or loss occurred within the company or bank.

c) Balance Sheet

Balance sheet is defined as the form of a financial position summary of company or bank at a particular point of time (Ramachandran et al., 2009). The position is shown in the list of all the things of values (assets) owned by the company or bank and the other side is the payables owed by the company or bank.

d) Financial Ratio Calculation

Several crucial ratios that have been assessment standard set by Bank of Indonesia in order to control and evaluate bank’s healthy. The ratios will include capital adequacy, asset quality, profitability, liquidity, compliance and minimum reserve requirement.

3.3.3 Operational Definitions

In order to fulfill this research can be carried out as expected it needs to understand the various elements that form the basis of a scientific research. The elements are
included in the operation of the research variables. Macnee & McCabe (2008) said that operational definition is a description of how the variable will be measured in the study. Furthermore, operational definition is used to represent or be the proxy for the conceptual definition. Although some researchers use Non Performing Loan (NPL) in their study, this study will not include NPL since NPL of two samples do not meet the requirement of normality test thus here are the operational definitions of this research:
<table>
<thead>
<tr>
<th>Variable</th>
<th>Concept</th>
<th>Indicators</th>
<th>Scale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Adequacy Ratio</td>
<td>CAR (X1): It shows bank’s capacity degree to meet its liabilities and risks by bank’s capital</td>
<td></td>
<td>Ratio</td>
</tr>
<tr>
<td>(X1)</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Return on Assets</td>
<td>ROA (X2): It shows the profitability on the assets of the firm after all expenses and taxes.</td>
<td></td>
<td>Ratio</td>
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<tr>
<td>(X2)</td>
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<tr>
<td>Return on Earnings</td>
<td>ROE (X3): It shows bank’s ability in terms of managing its equity for generating the profit after taxes.</td>
<td></td>
<td>Ratio</td>
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<tr>
<td>(X3)</td>
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<tr>
<td>Operating Efficiency Ratio</td>
<td>OER (X4): It shows a measurement bank management’s ability to control operating expenses to operating income.</td>
<td></td>
<td>Ratio</td>
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<tr>
<td>(X4)</td>
<td></td>
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<tr>
<td>Loan to Deposit Ratio</td>
<td>LDR (X5): It shows the ability of banks to take control of theirs capacity for issuing deposits or loans.</td>
<td></td>
<td>Ratio</td>
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<tr>
<td>(X5)</td>
<td></td>
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</tbody>
</table>
3.5 Data Collection Procedure
To collect or gather all data needed for the research, there are two methods of data collection to be used as follows:

a) Literature Studies
   This method is used by collecting data and any theory relevant to the topic to be investigated. The researcher will study the literature and other materials such as articles, journals, books and previous researches.

b) Documentary Studies
   Another collection data method is to gather all secondary data needed in the form of annual financial statements of each bank obtained from Bank of Indonesia’s library on its official site and also from the website of the banks concerned.

From all data gathered, it will be filtered which ones are included as computer processable data. Those processable data will be input and calculated in a statistic tool for research. The tool used in this research is Statistical Package for the Social Sciences (SPSS).

3.6 Testing the Hypothesis
During data process of the research, the researcher uses statistical techniques in the form of Independent T-test. Since this research sample consists of two different populations (Islamic and conventional banking) so the statistic test that will be used is Independent T-test.
According to Hatcher (2003), Independent T-test is aimed to test the hypothesis that have been constructed for getting analysis of significant differences between two groups of banking, Islamic and conventional. The purpose of this hypothesis test is to determine whether the hypothesis is accepted or rejected. There are three phases for testing hypothesis used Independent T-test as follows:
a) **Phase 1  ➔ Normality Assumption Test**

According to Jackson (2008), in most researches, normality test is well-known to be completed as the first assumption which is for testing whether the input data is normally distributed. Independent Sample T-test needs to have assumptions that data comes from a normally distributed population. A straight diagonal line is represented the normal distribution format and if the data is valued normal, the observed data will follow the diagonal line. In numerical results, Schlotzhauer (2007, p.150) explained that normality test will evaluate histogram of data distribution which should be shaped like a bell and the plots of data which should be around the diagonal line.

b) **Phase 2  ➔ Homogeneity Assumption Test using Levene’s test (F-test)**

F-test is conducted to answer the question of “Can variance of the two populations be considered equal or assumed to be homogeneous?” (Peer, 2012, p.235). This test should be done before T-test because T-test essentially requires the similarity variance of two populations tested.

Hypothesis for variance test:

Ho: $\sigma^2_1 = \sigma^2_2$

Ha: $\sigma^2_1 \neq \sigma^2_2$
With the conditions:

If $F$-value $> F$-table then $H_0$ is rejected and $H_a$ is accepted
If $F$-value $< F$-table then $H_0$ is accepted and $H_a$ is rejected

Or:

If the $p$-value $> 0.05$ then $H_0$ is accepted and $H_a$ is rejected
If the $p$-value $< 0.05$ then $H_0$ is rejected and $H_a$ is accepted
c) Phase 2 \(\rightarrow\) Independent T-test

After all assumption is correct and no doubtful to continue the data processed, the researcher will perform the main test of the research in which to find out the difference between Islamic and conventional banks in terms of financial performance.

Hypothesis:

- \(H_01: \) There is no significant difference in financial performance between Islamic and conventional banks based on CAR (\(X_1\)).
- \(H_{a1}: \) There is significant difference in financial performance between Islamic and conventional banks based on CAR (\(X_1\)).

- \(H_02: \) There is no significant difference in financial performance between Islamic and conventional banks based on ROA (\(X_2\)).
- \(H_{a2}: \) There is significant difference in financial performance between Islamic and conventional banks based on ROA (\(X_2\)).

- \(H_03: \) There is no significant difference in financial performance between Islamic and conventional banks based on ROE (\(X_3\)).
- \(H_{a3}: \) There is significant difference in financial performance between Islamic and conventional banks based on ROE (\(X_3\)).
H₀₄: There is no significant difference in financial performance between Islamic and conventional banks based on OER (X₄).

Hₐ₄: There is significant difference in financial performance between Islamic and conventional banks based on OER (X₄).

H₀₅: There is no significant difference in financial performance between Islamic and conventional banks based on LDR (X₅).

Hₐ₅: There is significant difference in financial performance between Islamic and conventional banks based on LDR (X₅).

With conditions:
If \( t \)-value > \( t \)-table, \( H₀ \) is accepted and \( Hₐ \) is rejected.
If $t$-value < $t$-table, $H_0$ is rejected and $H_a$ is accepted

Or:
If $t$-value $> 0.05$, $H_0$ is accepted and $H_a$ is rejected
If $t$-value $< 0.05$, $H_0$ is rejected and $H_a$ is accepted

Figure 3.1: Research Method Flowchart
CHAPTER IV

ANALYSIS AND INTERPRETATION

4.1 Company Profile

4.1.1 Islamic Banks

A. PT Bank Syariah Mandiri

PT Bank Syariah Mandiri or BSM is established in 1999 after a great economic and monetary crisis during 1997-1998. The presence of BSM might contribute in economic healing as known that during the crisis the national political stage led to many negative impacts on all aspects including business or financing industry. Experiencing this crisis, banking sector was dominated by conventional banking therefore the government tried to stabilize the condition by implementing restructuring and recapitalization of banks in Indonesia. Other than that, the government got new solution to increase the growth by establishing Islamic Banking Development Team. This team was created for initializing the aim recorded in the enactment of Law No. 10 Year 1998 to develop Islamic banking services in which the commercial banks are allowed to serve Islamic transactions (dual banking system).

According to official site of PT Bank Syariah Mandiri, BSM is originally formed from PT Bank Susila Bakti (BSB) held by Employee Welfare Foundation (YKP).
BSB was conversed by Islamic Banking Development Team in the part of its system and infrastructure from a conventional bank to Islamic bank with the name of PT Bank Syariah Mandiri as per Deed: Sutjipto, S.H., No. 23, 8 September 1999. The confirmation of change in business activity is proven by the Governor of Bank Indonesia Decree No. 1/24/KEP.BI/1999 dated 25 October
1999. Furthermore, the change of name from PT Bank Susila Bakti (BSB) to PT Bank Syariah Mandiri (BSM) is reflected in Decree Senior Deputy Governor of Bank Indonesia No. 1/1/KEP.DGS/1999. Until present, BSM has been performing well and growing rapidly become one of top Islamic banks in Indonesia lately based on Keuangan Kontan, a mass media focusing on banking and finance sector. Wibawa (2013) informed that BSM has successfully won the first place of the most profitable Islamic bank in 2012 with net profit of 805.6 billion rupiahs. Definitely, during performing to help Indonesia create ideal economic condition, BSM will always still embrace one of the hallmarks of BSM itself which is harmony between the ideals of business and spiritual values in all business activities.

B. PT Bank Muamalat Indonesia

PT Bank Muamalat Indonesia or BMI was established in 1 November 1991, initiated by the Indonesian Ulama Council (MUI) and the Government of Indonesia. BMI commenced operations on 1 May 1992. On 27 October 1994, Bank Muamalat succeeded in the title as a foreign exchange bank. This recognition has cemented its position as the first and leading Islamic banks in Indonesia with a variety of products and services are constantly being developed. When Indonesia was hit by the financial crisis that devastated most of the Southeast
Asian economies, National banking sector collapsed under bad loans in the corporate segment and Bank Muamalat is also affected by the economic crisis. In 1998, the ratio of bad financing (NPF) reached more than 60%. This bank recorded a loss of 105 billion rupiahs. Further, the equity reached its lowest point even it was less than a third of the initial paid up capital.

To strengthen its capital base, Bank Muamalat is looking for potential investors and the Islamic Development Bank (IDB) responded to
become one of major shareholders of this Islamic bank then officially happened at the Annual General Meeting on 21 June 1999. Moreover, Bank Mumalat currently provides services through 275 outlets spread across 33 provinces in Indonesia. BMI network is also supported by an alliance through more than 4000 online post office/SOPP in Indonesia, 32,000 ATMs and 95,000 debit merchant. BMI also expands its existence by building the branch abroad in Kuala Lumpur, Malaysia.

The difference between PT Bank Syariah Mandiri and PT Bank Muamalat Indonesia is based on the product segmentation where PT Bank Syariah Mandiri includes investment in gold as one of their features (BSM Gadai Emas and BSM Cicil Emas) whilst PT Bank Muamalat Indonesia has a strength in its international banking services such as remittance BMI (Maybank, BMMB and NCB) and trade finance (Export, Import, Export- Import Non LC Financing).

4.1.2 Conventional Banks

A. PT Bank Tabungan Negara

In 1897, this bank was established with the name of Postpaar Bank but in 1950 it changed into Bank Tabungan Pos. The name of Bank Tabungan Negara or BTN was created in 1963 as per Perpu No. 4 Year 1963 and Law No.2 Year 1964. The government of Indonesia starts to own BTN since 1968 according to the Law No.
20 Year 1968. BTN is appointed by the government to provide mortgage (KPR) service to the customers in 1974 and BTN sets its vision to become the foremost bank in the financing of housing. The bank keeps growing by operationally doing business activities as public bank which issues obligation

Since 2008, BTN becomes the first bank ever in Indonesia to do register the transaction of Collective Investment Contract Asset-backed Securities (Kontrak Investasi Kolektif Beragun Aset) in Bapepam.
Then, BTN has been listed in Indonesia Stock Exchange starting from 2009.

B. PT Bank Negara Indonesia

Bank Negara Indonesia or BNI was founded in 1946 as the first bank formed and owned by the Government of Indonesia. BNI began to circulate the first official payment instrument issued by the Government of Indonesia, the ORI or Oeang Republic of Indonesia starting 30 October 1946 where until now the day is commemorated as the Day of National Treasury. Following the appointment of De Javsche Bank which is inherited from the Dutch Government as the Central Bank in 1949, the Government restricts the role of BNI as the circulation and central bank. BNI subsequently designated as a development bank and furthermore the bank is given the right to act as a foreign bank with direct access to foreign transactions. As the capital increase in 1955, the status of the State Bank Indonesia transformed into state-owned commercial banks. These changes underlie better service for national business sector.

In 1992, the legal status and the name changed to PT BNI Bank Negara Indonesia (Persero). And, the decision to become a public company realized an initial public offering on the stock market in 1996. In 2004, an updated corporate identity began to be used to describe the
prospect of a better future after the success of wading through the difficult times. The term Bank BNI is shortened to BNI, while the establishment “46” used in the company’s logo to reinforce pride as the first national bank that was born in the era of the Republic of Indonesia.

The government of Indonesia held 60% stakes in BNI by the end of 2012 while the remaining 40% was owned by public shareholders including individual and institutional. Currently, BNI is the 4th largest
bank in Indonesia by assets, total loans and total deposits. BNI offers integrated financial services to customers supported by its subsidiaries: Bank BNI Syariah, BNI Multi Finance, Securities and BNI Life Insurance.

The difference between PT Bank Tabungan Negara (BTN) and PT Bank Negara Indonesia (BNI) focuses on the sub business core where BTN more deals with individual credit in housing such as Kredit Griya Utama, Kredit Griya Multi, Home Store Ownership Credit and Kredit Swa Griya while BNI takes more attention in usual consumer banking like other conventional banks such as savings, deposits and credit card. However, BNI has a strength in expanding its business to international stage such as BNI New York, BNI London, BNI Tokyo, BNI Singapore and BNI Hong Kong.

4.2 Data Result Analysis
4.2.1 Descriptive Statistics
The following tables shown below (Table 4.1) capture general descriptive information of all data observed in this study since the researcher uses not only quantitative analysis but also descriptive analysis. The descriptive statistics table will help to explain statistics information of both Islamic and conventional banking. The table contains of mean and also standard deviation of all variables used in the research (CAR, ROA, ROE, OEOI and LDR).
Table 4.1: Descriptive Statistics of Islamic and Conventional Banking

<table>
<thead>
<tr>
<th>Group Statistics</th>
<th>Type of Banking</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Std. Error Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>CAR</td>
<td>62</td>
<td>12.8021</td>
<td>1.57007</td>
<td>.19940</td>
</tr>
<tr>
<td></td>
<td>Islamic Bank</td>
<td>62</td>
<td>17.1071</td>
<td>2.10114</td>
<td>.25684</td>
</tr>
<tr>
<td></td>
<td>Conventional Bank</td>
<td>62</td>
<td>1.9226</td>
<td>.59036</td>
<td>.07498</td>
</tr>
<tr>
<td></td>
<td>ROA</td>
<td>62</td>
<td>1.9613</td>
<td>.63298</td>
<td>.08038</td>
</tr>
<tr>
<td></td>
<td>Islamic Bank</td>
<td>62</td>
<td>18.2460</td>
<td>5.07208</td>
<td>.64415</td>
</tr>
<tr>
<td></td>
<td>Conventional Bank</td>
<td>62</td>
<td>37.3584</td>
<td>18.41344</td>
<td>2.33851</td>
</tr>
<tr>
<td></td>
<td>ROE</td>
<td>62</td>
<td>81.0337</td>
<td>6.51049</td>
<td>.92693</td>
</tr>
<tr>
<td></td>
<td>Islamic Bank</td>
<td>62</td>
<td>82.5119</td>
<td>6.80856</td>
<td>.86443</td>
</tr>
<tr>
<td></td>
<td>Conventional Bank</td>
<td>62</td>
<td>93.6227</td>
<td>6.65976</td>
<td>.84579</td>
</tr>
<tr>
<td></td>
<td>LDR</td>
<td>62</td>
<td>84.7527</td>
<td>19.81293</td>
<td>2.51024</td>
</tr>
</tbody>
</table>

Source: SPSS Data Processed

Based on Table 4.1, it shows five independent variables to test; CAR, ROA, ROE, OEOI and LDR with 62 data per each type of banking (N=62, 2 banks x 7.75 years) where generated from quarterly publication report of four representative banks (PT Bank Syariah Mandiri, PT Bank Muamalat Indonesia, PT Bank Tabungan Negara and PT Bank Negara Indonesia) starting from 2006 to 2013. From Table 4.1, CAR mean value of Islamic banking (M=12.8021, σ=1.57007) is lower than conventional banking (M=17.071, σ=2.10114).

Table 4.1 also shows that mean value of ROA for Islamic banking (M=1.9226, σ=0.59036) in the period of 2006 – 2013 is not quite different from ROA mean value of conventional banking (M=1.9613, σ=0.63288) which is slightly higher.

In terms of ROE, the mean value for Islamic banking
(M=37.3584, σ=18.41344) is above conventional banking (M=18.2460, σ=5.07208) during 2006 – 2013. Besides that, along 7.75 years Islamic banking obtained OER mean value (M=81.0337, σ=6.51049) which is not quite
different from conventional banking ($M=82.551, \sigma=6.80656$) indicating that the conventional banks is above Islamic banks in terms of OER. But, on the other hand, based on Table 4.1, Islamic banking got mean value of LDR quite higher ($M=93.6227, \sigma=6.65976$) which is significantly above conventional banking ($M=84.7527, \sigma=19.81293$).

4.2.2 Assumption Test

A. Normality Test

(I) CAR

Figure 4.1: Histogram of Variable CAR for Islamic Banking

Figure 4.2: Plot Normal Output

Figure 4.3: Histogram of Variable CAR for Conventional Banking

Figure 4.4: Plot Normal Output
Figure 4.1 and Figure 4.3 are the histograms that reflect variable CAR distribution of Islamic and conventional banking. Those two histograms show that the data are normal distribution since the graphs have a shape line like a bell.

To determine that Islamic banking data for variable CAR is normally distributed, Figure 4.2 shows plot normal of variable CAR from Islamic banking group and the plots are close by the line which normal distribution is already passed by Islamic banking in terms of variable CAR. Conventional banking is also indicated to have normal distribution as proven by plot normal output in Figure 4.4 above. The graph also shows all data plots of Variable CAR appeared around the line. Therefore, variable CAR of conventional banking meets the requirement of normality.

(II) ROA

Figure 4.5: Histogram of Variable ROA for Islamic Banking

Figure 4.6: Plot Normal Output
Figure 4.7: Histogram of Variable ROA for Conventional Banking

Figure 4.8: Plot Normal Output
As per Figure 4.5, the histogram indicates a normal distribution happened in variable ROA of Islamic banking. It produces a shape like a bell. A histogram shown above (Figure 4.7) also represents that conventional banking also had normally distributed variable ROA where the graph has bell shape drawn.

Based on Figure 4.6 and 4.8, the pictures also determine that Islamic banking has normal distribution for its variable ROA in another way. The plots are still around the diagonal line which means the distribution of data for variable ROA in Islamic banking is normal. No plot is far away from the line. Thus, four pictures above conclude variable ROA of Islamic and conventional banking passed normality test.
(III) ROE

Figure 4.9: Histogram of Variable ROE for Islamic Banking

Figure 4.10: Plot Normal Output

Figure 4.11: Histogram of Variable ROE for Conventional Banking

Figure 4.12: Plot Normal Output
Histograms of variable ROE for both Islamic and conventional banking are shown in the Figure 4.9 and 4.11 which represent that there is normally distribution of variable ROE not only Islamic but also conventional banking where two of them are seen like a bell shape. Another proof can be figured out by seeing normal plot which is indicated by Figure 4.10 for Islamic banking and Figure 4.12 for conventional banking. In Figure 4.10, the plots are normally distributed where no plot appears far away from diagonal line.

Likewise, conventional banking also has normal distribution of data by analyzing its plot normal output in terms of ROE. ROE values of conventional banking since 2006 to 2013 surprisingly met the requirement of normality test which the picture shows no plot leaves the line too far. In fact, they follow diagonally approaching the line as seen in the Figure 4.12. Both histograms and plot normal output are the consideration that the researcher decides variable ROE data is eligible to be tested in the next level of analysis.
Based on Figure 4.13, variable OER for Islamic banking starting from 2006 to 2013 is defined as a normal distribution where the histogram shaped like a bell. Variable OER of conventional banking also has same result with Islamic banking where histogram is shown in Figure 4.15.

In addition, the researcher found the normal plot output for variable OER that owned by Islamic banking where is shown they abreast with the diagonal line (Figure 4.14). According to Figure 4.16, normal distribution of variable OER for conventional banking is concluded to pass normality test since the plot normal output shows plots appear close by the diagonal line.
(V) LDR

Figure 4.17: Histogram of Variable LDR for Islamic Banking

Figure 4.18: Plot Normal Output

Figure 4.19: Histogram of Variable LDR for Conventional Banking

Figure 4.20: Plot Normal Output
Islamic banking is proven to completely pass normality test since Figure 4.17 which is a histogram that captures a normal data distribution of variable LDR occurred in 2006 – 2013. This conclusion comes up when the researcher found the histogram shows a shape like bell. Besides that, Figure 4.19 shows variable LDR owned by conventional banking in 2006 – 2013 was also normally distributed.

If seen by plot normal output, both Islamic (Figure 4.18) and conventional banking (Figure 4.20) also have been proven that their LDR data is included as normal distribution where no one plot is in the far distance from the diagonal line.

B. Homogeneity Test

After passing through normality test, Islamic and conventional banking data will be identified whether those samples from two populations have same variances or not. Before analyzing the difference of these two populations using independent T-test, it needs to be observed their homogeneity. To determine the homogeneity, Levene’s test is usually used by the researchers since this test can be utilized not only for primary statistical analysis but also to identify underlying homogeneous assumption associated with the statistical analysis of compared means (Gibbons, 2007). Homogeneity is indicated when \( p \)-value > \( p \)-table.
where p-table is 0.05 based on the hypothesis. Nonetheless, it doesn’t mean that if the populations are not homogeneous then they could not be tested through independent T-test. Once this test is done, the researcher will know which output numbers will be observed in the independent T-test based on whether they are homogenous or not.
Table 4.2 shows numbers of $p$-value generated from all variables observed. As mentioned in the table, in terms of CAR, the researcher concludes that Islamic and conventional banking variances are homogenous ($F=2.851$, $p=0.094$) which is greater than 0.05 ($p$-value $> p$-table).

For variable ROA within 2006 – 2013, it also indicates homogeneity between variances of two populations ($F=0.006$, $p=0.936$) where the significance value is greater than 0.05 ($p$-value $> p$-table). Likewise, variable OER has $p$-value ($F=0.028$, $p=0.868$) that is higher than 0.05 ($p$-value $> p$-table) so the variances between Islamic and conventional banking are equal.

But it seems the result not to be the same as variable ROE
and LDR where the researchers found in Levene’s test result ROE \( p \)-value \( (F=71.035, \ p=0.000) \) and LDR \( p \)-value is less than 0.05 \( (p\text{-value} < p\text{-table}) \) causing
that two populations’ variances are not homogenous in terms of ROE and LDR.

4.2.3 Hypothesis Analysis

This is the main part of analysis which all variables will be observed to test the research hypothesis. Below (Table 4.3) is a table that shows Levene’s test result and independent T-test for equality of means between Islamic and conventional banking with observed variables; CAR, ROA, ROE, OER and LDR. Firstly, through Levene’s test, if the variable has not significant different in variance (homogeneous) so it is assumed as “Equal Variances Assumed”. The researcher should find independent T-test result from “Equal Variances Assumed” perspective.

Then, if the variable has significant different in variance which is “Equal Variances Not Assumed”, the researcher should observe independent T-test result from “Equal Variance Not Assumed” perspective. The analysis will be explained in detail one by one per variable in the next explanation.
Table 4.3: Independent T-test

<table>
<thead>
<tr>
<th>Variable</th>
<th>Levene's Test</th>
<th>t-test for Equality of Means</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>F</td>
<td>Sig.</td>
</tr>
<tr>
<td>CAR</td>
<td>Equal variances assumed</td>
<td>2.851</td>
</tr>
<tr>
<td></td>
<td>Equal variances not assumed</td>
<td>-12.923</td>
</tr>
<tr>
<td>ROA</td>
<td>Equal variances assumed</td>
<td>0.006</td>
</tr>
<tr>
<td></td>
<td>Equal variances not assumed</td>
<td>-0.352</td>
</tr>
<tr>
<td>ROE</td>
<td>Equal variances assumed</td>
<td>71.053</td>
</tr>
<tr>
<td></td>
<td>Equal variances not assumed</td>
<td>7.879</td>
</tr>
<tr>
<td>OER</td>
<td>Equal variances assumed</td>
<td>0.028</td>
</tr>
<tr>
<td></td>
<td>Equal variances not assumed</td>
<td>-1.269</td>
</tr>
<tr>
<td>LDR</td>
<td>Equal variances assumed</td>
<td>72.701</td>
</tr>
<tr>
<td></td>
<td>Equal variances not assumed</td>
<td>3.341</td>
</tr>
</tbody>
</table>

Source: SPSS Data Processed
Furthermore, another supporting table (Table 4.4) will assist the researcher to double check whether the decision of hypothesis is totally valid and correct. In this table, each variable has the information about the difference with 95% confidence interval observed. Based on Elliot (2006, p.64), the rule of decision making using confidence interval is when the interval includes zero (0) between lower and upper then it is strongly believed that the means have no significant difference. Meanwhile, if the interval does not include zero (0), the researcher will completely conclude that there is significant difference between these two means (Islamic and conventional banking). The detail explanation per variable will be also provided in the next part.

<table>
<thead>
<tr>
<th>Variable</th>
<th>95% Confidence Interval of the Difference</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Lower</td>
<td>Upper</td>
</tr>
<tr>
<td>CAR</td>
<td>Equal variances assumed</td>
<td>-4.964</td>
</tr>
<tr>
<td></td>
<td>Equal variances not assumed</td>
<td>-4.965</td>
</tr>
<tr>
<td>ROA</td>
<td>Equal variances assumed</td>
<td>-0.256</td>
</tr>
<tr>
<td></td>
<td>Equal variances not assumed</td>
<td>-0.256</td>
</tr>
<tr>
<td>ROE</td>
<td>Equal variances assumed</td>
<td>14.311</td>
</tr>
<tr>
<td></td>
<td>Equal variances not assumed</td>
<td>14.275</td>
</tr>
<tr>
<td>OER</td>
<td>Equal variances assumed</td>
<td>-3.886</td>
</tr>
<tr>
<td></td>
<td>Equal variances not assumed</td>
<td>-3.886</td>
</tr>
<tr>
<td>LDR</td>
<td>Equal variances assumed</td>
<td>3.615</td>
</tr>
<tr>
<td></td>
<td>Equal variances not assumed</td>
<td>3.581</td>
</tr>
</tbody>
</table>

Source: SPSS Data Processed

(I) Analysis of CAR
Refer to Table 4.3, since variances between Islamic and conventional banking of variable CAR are equal (Equal Variances Assumed) as explained in the homogeneity test previously where 0.094 > 0.05 (p-value > p-table) therefore the researcher used “Equal Variances
Assumed” for $t$-value. Both Islamic and conventional banking means are significantly different in terms of variable CAR ($t=-12.923$, df=122, $p=0.000$) where significant $t$-value < 0.05 then $H_0$ is rejected and $H_a$ is accepted.

To ensure the decision is correct, the researcher tried to look into confidence interval of the difference of variable CAR (Table 4.4) where CAR produced lower value -4.964 and upper -3.646. The intervals (-4.964 to -3.646) include zero (0) then the researcher confidently concludes that there is significant difference between two means of both Islamic and conventional banking in terms of variable CAR.

(II) Analysis of ROA

Based on Table 4.3, it shows that $F$-value of variable ROA ($F=0.006$, $p=0.936$) is higher than 0.05 which indicates these two population have equal variances or “Equal Variances Assumed”. With “Equal Variances Assumed” perspective, These two populations are not significantly different in terms of variable ROA ($t=0.352$, df=122, $p=0.725$) where significance $t$-value is higher than 0.05 where based on hypothesis and method when $t$-value > $t$-table it says $H_0$ is accepted and $H_a$ is rejected. Furthermore, according to Table 4.9 below, the researcher also found the decision is totally true.
In terms of ROA, the intervals lie between -0.256 to 0.179 (see Table 4.4). Zero (0) is definitely existed between -0.256 and 0.179 so this concludes a 95% confidence interval on the difference between Islamic and conventional banking with 122 degree of freedom proves that there is no significant difference in means.
(III) Analysis of ROE

Table 4.3 identifies that the observation of independent T-test towards variable ROE will use “Equal Variances Not Assumed” perspective since the significance of F-value is lower than 0.05 ($p$-value < $p$-table). Seeing the result of independent T-test in the perspective of “Equal Variances Not Assumed” ($t=7.879$, df=70.204, $p=0.000$) where significance $t$-value is lower than 0.05 which means Islamic and conventional banking have significant difference in means looking by variable ROE, in the other words, $H_a$ is accepted instead of $H_0$.

According to Table 4.4, the lower value of ROE between Islamic and conventional banking is 14.311 while the upper value is 23.914. These intervals do not include zero (0) which the researcher definitely concluded that those types of banking are proven that they are significantly different in means compared by variable ROE.

(IV) Analysis of OER

Based on Table 4.3, in the Levene’s test, the exact result shows that the variances are typically homogeneous where $H_0$ of homogeneity test is fully rejected or it can be said that both populations have equal variances (“Equal Variances Assumed”). Therefore, to ensure observation for the independent T-test is valid, the researcher looked at the result in “Equal Variances
Assumed” perspective where significance of $t$-value ($t=-1.269$, df=122, $p=0.207$) is higher than 0.05 ($t$-value $> t$-table). This means two populations of banking industry are not significantly different in means or $H_0$ is accepted by seeing variable OER. This conclusion is also supported by detailed information from confidential interval as following table shown (Table 4.4).
Table 4.4 gives more information that the researcher can be confident to conclude the decision for variable OER analysis. As seen in the table above, variable OER of Islamic and conventional banking has lower value of -3.886 and upper value of 0.850 in which zero (0) is included among these intervals. When zero is included in the intervals, the researcher should conclude that there is no significant difference between two populations, in this case, looked by variable OER sight.

(V) Analysis of LDR

From Table 4.3, since variances between Islamic and conventional banking of variable LDR are not equal (Equal Variances Not Assumed) as explained in the homogeneity test previously where $p$-value of LDR is 0.000 (lower than 0.05) therefore the researcher used “Equal Variances Not Assumed” for analyzing independent $t$-test. Islamic and conventional banking means are significantly different in terms of variable LDR because significance $t$-value < $t$-table ($t=3.341$, $df=74.610$, $p=0.001$). This conclusion is also proven by seeing confidence interval in Table 4.4.

In terms of LDR, the intervals are statistically observed with the lower value of 3.615 and the upper value of 14.125 (see Table 4.4). Zero (0) is not definitely existed between 3.615 and 14.125 so this concludes a 95% confidence interval on the difference between Islamic
and conventional banking proves that there is a significant difference in means between these two populations of banking.

4.3 Interpretation of Results

In Indonesia, Islamic banking has been rapidly growing up and been trying to compete with the other type of banking system which has been popular known by people, conventional banking. These two banks not only
compete based on service point of view but also financial performance. As known by theory stated that Islamic and conventional banking have different component and element in financial statements. Statistically, it is proven by the research result. According to the result of this research, through variables CAR, ROE and LDR where \( t \)-value is lower than \( t \)-table \( (t\text{-value} < 0.05) \), Islamic and conventional banking are assessed that they are significantly different from each other.

\( I \) Difference in CAR between Islamic and conventional banking

Specifically, CAR has \( t \)-value of 0.000 with the interval associated with the assumption of equal variances from \(-4.964\) to \(-3.646\) between Islamic and conventional banking. This numbers is interpreted to identify that in terms of variable CAR, these two types of banking do have significant difference. Thus, this result is completely same as Arie Firmanasyah Saragih, Widya Wahyu Ningsih, M. Thamrin, Liviawati and Rita Wiyati on their research that both Islamic and conventional banking are significantly different in terms of CAR. As related to the theory, when bank generates higher CAR, it means bank has greater adequate capital. Therefore, this result also concludes conventional banking mean value of 17.11% that conventional banking is better in managing its primary capital and supplementary capital rather than Islamic banking in the last 7,75 years rather than Islamic banking. This conclusion can be proved by the monitoring report done by Bank of Indonesia where in the end of 2012, it is proven also that no Islamic bank is included in the group of BUKU III and IV because they did not have really high CAR based on the research (Agustianto, 2013). However, both banking groups still met the standard required by Bank of Indonesia which is between 8% - 9%.
(II) Difference in ROE between Islamic and conventional banking

The result is proven that Islamic and conventional banking are different significantly where \( t \)-value is lower than 0.05. This also reflects same result with M. Thamrin, Liviawati and Rita Wiyati on their research in which ROE between these two types of banking are significantly different. However, Islamic banking did not always come beaten by conventional banking. On the contrary, The supporting idea does prove when the researcher also found that \( t \)-value of independent T-test yielded positive number (7.879) which indicated ROE mean value of Islamic banking is higher than conventional banking (37.36\% for Islamic banks and 18.25\% for conventional banks). Even more, by this number, Islamic banks exceed the requirement of ROE value that set up by central bank which any bank will be given additional points if its ROE is higher than 12.5\% as per minimum requirement from Bank of Indonesia but conventional banking is still categorized in succeeding the minimum requirement too.

(III) Difference in LDR between Islamic and conventional banking

In terms of LDR, there is also a significant difference between Islamic and conventional banking since significance \( t \)-value of LDR is 0.001 (\( t \)-value < 0.05) as same as Widya Wahyu Ningsih’s research that stated Islamic and conventional banking are significantly different in LDR. Once again, Islamic banks have
successfully performed much better than conventional banks because $t$-value is valued in positive number (3.341) which means the mean value of first population (Islamic banking) is greater than the second population (conventional banking). It is proven that during 2006 – 2013, Islamic banking had a mean value of 93.62% where the gap was 8.87% towards conventional banks’ mean value of 84.75%. Somehow, only Islamic banking completely met the requirement from Bank of Indonesia to gain LDR value between 85% - 100%.
Based on ROE and LDR, Islamic banking in Indonesia shows the strength of Sharia system. However, there are only two variables that showed they are not significantly different which may have. Based on the research, $t$-value of ROA (0.765) and OER (0.207) which is known higher than 0.05 as $t$-table, Islamic and conventional banking are identified not significantly different in terms of ROA and OER point of views. This statement is also supported by a research done by Arie Firmansyah Saragih that stated in Islamic and conventional do not differ significantly in ROA and OER. In addition, from the descriptive statistics done in this research showed difference between mean values of ROA and OER is not quite distant.

In terms of ROA, the indifference can be also proven since Islamic banking generated mean value of 1.92% while conventional banking generated 1.96%. But, they did meet the minimal requirement from Bank of Indonesia which is between 0.5% - 1.25%. From related theory, this result determines that Islamic banking is much better utilizing its assets to gain more profit rather than conventional banking.

In terms of OER, the result of research showed that these banking groups have no significant difference not only because $t$-value > $t$-table but also it can be seen by the difference of mean value is not really high where Islamic banks had OER mean value of 81.03% whilst the
conventional banks owned mean value of 82.55%. Bank of Indonesia sets up that the bank will be considered have healthy condition regarding its financial performance if OER value does not exceed 94% - 96% therefore based on the research, Islamic and conventional banks are indicated as healthy banks since the number of OER is even below 94%.

This identifies that both banking type are in the good position covering their operational expenses by their operating incomes. In additional, according to monitoring report from Bank of Indonesia, Islamic banking
had powerful efficiency rather than conventional banking because it is supported by the increase in revenue as the continued expansion of credit and operational efficiency improvements (e.g. reducing overhead costs).
CHAPTER V CONCLUSION

AND RECOMMENDATION

5.1 Conclusion

Based on the result from the research and discussion on the previous chapter refers to the problems and research objectives, it can be concluded as follows:

1. Based on statistic test used independent T-test result, CAR obtained significance value of 0.000 < 0.05 which concluded H0 is rejected and Ha is accepted that means there is a significant difference between Islamic and conventional banking in terms of CAR. The mean value of CAR between Islamic and conventional banking showed that conventional banking CAR value is above the Islamic banking. However, Islamic banking CAR exceeded minimum requirement set by Bank of Indonesia, 8% - 9%.

2. Based on statistic test used independent T-test result, ROA obtained significance value of 0.725 > 0.05 which concluded H0 is accepted and Ha is rejected that means there is no significant difference between Islamic and conventional banking in terms of ROA. The mean values of ROA between Islamic and conventional banking are not significantly different but both banking groups successfully exceeded minimum requirement set by Bank of Indonesia, 0.5% - 1.25%.

3. Based on statistic test used independent T-test result, ROE obtained significance value of 0.000 < 0.05 which concluded H0 is rejected and Ha is accepted that means there is a significant difference
between Islamic and conventional banking in terms of ROE. The mean value of ROE between Islamic and conventional banking showed that Islamic banking ROE value is quite higher than the conventional banking. However, conventional banking ROE still exceeded minimum requirement set by Bank of Indonesia, 5% - 12.5%.

4. Based on statistic test used independent T-test result, OER obtained significance value of 0.207 > 0.05 which concluded H0 is accepted and Ha is rejected that means Islamic and conventional banking are not significantly different in terms of OER. The mean value of OER between Islamic and conventional banking showed that conventional banking value are not quite different but both banking groups still controlled their efficiency not to exceed more than 96% set by Bank of Indonesia.

5. Based on statistic test used independent T-test result, LDR obtained significance value of 0.001 < 0.05 which concluded H0 is rejected and Ha is accepted that means Islamic and conventional banking are significantly different in terms of LDR. The mean value of LDR between Islamic and conventional banking showed that Islamic banking LDR value is above the conventional banking. Indeed, conventional banking LDR had not met minimum requirement set by Bank of Indonesia, 85% - 100%.

Therefore, the result of this research has given a picture that the banks from Islamic banking and state owned conventional banking that have gained profit between 1,000,000 – 10,000,000 (in million rupiahs) are significantly
different in terms of CAR, ROE and LDR but not different in ROA and OER but they together successfully met the minimum requirement of being healthy bank set by Bank of Indonesia.
5.2 Recommendation

From the conclusion above, the researcher could give several recommendations such as:

1. To Islamic Banks
   In general, performance of Islamic banks has been qualified as a moderate healthy bank by measuring the five financial ratios (CAR, ROA, ROE, OER and LDR) but in terms of CAR, since the value is lower than conventional banking, management team of Islamic banks should put more efforts and pay attention to the capital needs for every credit expansion. Islamic banking may be more careful to make a decision in managing their assets. It would be better if they ensure that every single risky asset should earn sufficient income therefore Islamic banks do not really put a pressure to their capital adequacy.

2. To Conventional Banks
   Generally, performance of conventional banking in terms of capital adequacy and profitability is assessed healthier rather than Islamic banking but it does not prevail if seen from liquidity point of view (LDR). Therefore, management team of conventional banking may consider on the easiness of lending requirement including credit card application, mortgage loans and credit distribution to entrepreneurs.

3. To Students
   Analyzing financial performance of financial institution
such as banks is undeniable useful and meaningful to students especially Banking and Finance students. The analysis may help students to understand what and how banks perform their activities further students may know how to assess which one the banks are identified as healthy banks. By doing financial performance analysis, students will also gain more understanding how financial ratios are used and useful.
4. To Future Researchers

This research only used five financial ratios covering capital adequacy, profitability and liquidity measurement to analyze financial performance of Islamic and conventional banking thus it is advisable for future researchers to choose and use more ratios in order to get wide financial highlight. In addition, the future researchers are recommended to enlarge number of samples in order to be more generalized but they also have to be careful to get the right and appropriate samples from both Islamic and conventional banking populations.
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## APPENDIX I

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