SUMMARY

NADIAH HIDAYATI. The Efficiency Determinants and Its Impact on Profitability of Islamic Banking in Indonesia. Supervised by HERMANTO SIREGAR and SYAMSUL HIDAYAT PASARIBU.

The banking sector has an important role the Indonesian economy. Act No 21 of 2008 on Islamic banking reinforce the existence of Islamic bank in Indonesia. It provides an excellent opportunity for the growth of Islamic banking industry in Indonesia.

Islamic banking in Indonesia has a significant growth from the institutional side. Increasing number of banks and offices over the years have a positive impact on the development of Islamic banking industry. This can be seen from the value of total assets, third party funds (DPK), and financing were increased during the last three years.

The rapid growth of Islamic banking industry makes the efficiency's conditions of Islamic Banks (BUS) and Islamic Unit Business (UUS) be considered. BUS and UUS performance also can be seen through some financial ratios such as *Non Performing Financing* (NPF) and *Financing Deposit to Ratio* (FDR). Over the past three years, BUS and UUS have decreased performance. It can be seen from the increasing value of NPF and decreasing value of FDR. It indicates the performance of Islamic banking is still not running optimally.

Islamic banking is still providing a lower rate of return than conventional banking. The average ROA of Islamic banking during 2013-2015 is only 0.97 percent lower than conventional banking which has 2.75 percent average. Declining ROA ratio by the Islamic banking since 2013 due to the Islamic banking activities are still influenced by macro economic conditions.

Efficiency issues should have serious consideration to encourage the development of Islamic banking industry and the existence of Islamic banks. The majority of studies focused only on efficiency measures, while the study analyzes factors that affect the performance efficiency is still relatively limited, especially focus for the efficiency of Islamic banking. In addition, there is no study that focus on analyzing the efficiency determinants and its impact on profitability BUS and UUS in Indonesia.

Previous research on the efficiency of banking and factors that affect it, have been carried out with varying results. Research conducted by Sufian (2007), Yudistiara (2004), Mochtar *et al.* (2008), Suseno (2008), and Hidayat (2011) found various results regarding the level of efficiency in Islamic banking, while research conducted by Jackson and Fethi (2000), Zamil (2007), Sufian and Noor (2009), Endri (2010), Firdaus and Hosen (2013) found varying results regarding the factors that affect the level of banking efficiency.

Research conducted by Subandi and Ghozali (2013) and Widiarti (2015) only analyzed factors that affect the efficiency and the impact on profitability with the case on conventional banking. Therefore, this study aims to analyze the factors that affect efficiency and impact on profitability of BUS and UUS in Indonesia. This research using descriptive analysis, *Data Envelopment Analysis* (DEA)

method, and panel data regression on ten BUS and fifteen UUS, with study period during Q2 2014-Q2 2016.

The result showed that BUS and UUS in Indonesia do not operate efficiently, measured with DEA method. The panel data analysis result showed that financing and CAR have positive and significant impact on efficiency, while deposit wadiah has negative and significant impact on BUS and UUS in Indonesia. The study results showed that the growth of GDP and the exchange rate have positive and significant impact, whereas NPF and operational cost have negative and significant on ROA BUS and UUS in Indonesia.

Keywords: DEA, efficiency, Islamic banking, macro economic, panel data, profitability, ROA.