"THE IMPACT OF CAPITAL ADEQUACY, EFFICIENCY, SIZE, EQUITY, LIQUIDITY AND FEE BASED INCOME TO BEHAVIORS OF FUNDING AND FINANCING OF ISLAMIC BANKS IN INDONESIA" (JANUARY 2010 – DECEMBER 2014)

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Submitted in partial fulfillment of the requirement
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MOTTO

"A RESULT WILL NEVER BETRAY THE PROCESS" ERMANOELSE

"WE DO NOT NEED MAGIC TO CHANGE THE WORLD, WE CARRY ALL THE POWER WE NEED INSIDE OURSELVES ALREADY, WE HAVE A POWER TO IMAGINE BETTER" –JK ROWLING

"WORKING HARD IS IMPORTANT. BUT THERE IS SOMETHING THAT MATTERS EVEN MORE : BELIEVING IN YOURSELF" –HARRY POTTER

"EVERY GREAT WIZARD IN HISTORY HAS STARTED OUT AS NOTHING MORE THAN WE ARE NOW : STUDENTS. IF WE CAN DO IT, WHY NOT US?" HARRY POTTER

"IT IS OUR CHOICES THAT SHOW WHAT WE TRULY ARE, FAR MORE THAN OUR ABILITIES" -ALBUS DUMBLEDORE

This is not the great research afterall,

but I swear I've tried my best in writing this masterpiece...

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All praise and gratitude to Allah SWT, because only with His authority this undergraduate thesis entitle **"THE IMPACT OF CAPITAL ADEQUACY, EFFICIENCY, SIZE, EQUITY, LIQUIDITY AND FEE BASED INCOME TO BEHAVIORS OF FUNDING AND FINANCING OF ISLAMIC BANKS IN INDONESIA(JANUARY 2010 – DECEMBER 2014)"**has finally accomplished.

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ABSTRACT

This study aimed to see the behavior of funding and financing of Islamic Banks in Indonesia in years period January 2010 until December 2014. Bank as the financial intermediary institution take a role to facilitate the channeling between the parties who have excessive fund and distribute to the parties who need fund. Emphasise the important of funding and financing, this study aimed to see the implication of CAR, Efficiency, Size, Equity, Liquidity and Fee based income to the behavior of Funding and Financing.

This study used Data Envelopment Analysis to measure efficiency value through intermediary approach and Multiple Regression Analysis. The data used in this study are the data of Capital Adequacy Ratio (CAR), Efficiency, Asset, Equity, Financing to Deposit Ratio (FDR), Fee Based Income, Funding and Financing of Islamic Banks in Indonesia. The sample used were selected by purposive sampling method with some criterias. The samples are 11 Islamic Banks listed in Financial Service Authority database in years period January 2010 until December 2014.

From the test result using the Data Envelopment Analysis, There are some Islamic Banks in Indonesia which are still inefficient. Meanwhile based to Multiple Regression Analysis showed that CAR has positive impact to funding and no impact financing, Efficiency has no impact to both of funding and financing, Asset has no impact to funding but has positive impact to financing, Equity has no impact to funding and negative impact to financing, Liquidity has no impact to funding and has positive impact to financing, while Fee based income has no impact to both of funding and financing.

***Keywords** : CAR, Efficiency, Size, Equity, Liquidity, Fee based income, Funding, Financing.*

TABLE OF CONTENT

THESIS APPROVAL ii
APPROVAL iii
UNDERGRADUATE THESIS ORIGINALITY STATEMENT iv
MOTTO v
ACKNOWLEDGMENT vi
ABSTRACT ix
LIST OF TABLES xiii
LIST OF FIGURES xv
LIST OF APPENDIX xvi
CHAPTER I 1
INTRODUCTION 1
1.1 Background 1
1.2 Problem Identification 19
1.3 Research Objective 22
1.4 Research Outline 25
CHAPTER II 29
LITERATURE REVIEW 29
2.1 Definition and Theoretical Basis 29
2.1.1 Banking Theory 29
2.1.2 Theory of Cost Benefit Analysis 31
2.1.3 Capital Structure Theory 32
2.1.4 Banking Competitiveness Theory 33
2.1.5 Behavioral Finance Theory 33
2.1.6 Bank's Liquidity Theory 34
2.1.7 Definition of Bank 36
2.1.8 Classification of Bank 37

2.1.9 Definition and Operations of Islamic Commercial Bank 38
2.1.10 The Similarities and Differences between Conventional and Islamic Bank 39
2.1.11 Measuring Funding and Financing Behavior of Bank 41
2.2 Previous Researches 58
2.3 Hypothesis 60
2.4 Framework.. 67
CHAPTER III 70
RESEARCH METHODOLOGY 70
3.1 Variable of Research and Operational Definition of Variable 70
3.1.1 Operational Definition of Variables 89
3.2 Population and Sample 96
3.2.1 Population 96
3.2.2 Sample 96
3.3 Type and Source of Data 98
3.4 Methodology in Collecting Data 98
3.5 Methodology in Analyzing Data 99
3.5.1 Regression Analysis 99
CHAPTER IV 106
RESULT AND ANALYSIS 106
4.1. Object Description 106
4.2. Efficiency Analysis based on VRS DEA 110
4.3. Descriptive Statistic 111
4.4. Classical Assumption Test 118
4.4.1. Normality Test 118
4.4.2. Multicollinearity Test 125
4.4.3. Heteroscedasticity Test 111
4.5. Hypothesis Test 115
4.5.1. Determination Coefficient (R^2) 115

4.5.2. F Statistical Test 117
4.5.3. T Statistical Test 120
4.6 Discussion 126
4.6.1 The impact of capital adequacy to the funding's behavior 126
4.6.2 The impact of efficiency to the funding's behavior 127
4.6.3 The impact of size to the funding's behavior 128
4.6.4 The impact of liquidity to the funding's behavior 129
4.6.5 The impact of fee based income to the funding's behavior 130
4.6.6 The impact of capital adequacy to the financing's behavior 131
4.6.7 The impact of efficiency to the financing's behavior 132
4.6.8 The impact of asset to the financing's behavior 133
4.6.9 The impact of equity to the financing's behavior 134
4.6.10 The impact of liquidity to the financing's behavior 135
4.6.11 The impact of fee based income to the financing's behavior 135
CHAPTER V 137
CONCLUSION 137
5.1 Conclusion 137
5.2 Research Limitation 137
5.3Advice 138
5.3.1 Islamic Banking of Indonesia 138
5.3.2 The next research 139
BIBLIOGRAPHY 140
APPENDIX 144

LIST OF TABLES

Table 1. 1 Islamic Banking Network Years Period 1997 – 2015................................. 6
Table 1. 2 Islamic Commercial Bank and Islamic Business Unit Condensed Balance Sheet Years Period 1997 – 2015 7
Table 1. 3 The Micro Policy of Indonesian Banking Years Period 1997 – 2010 9
Table 1. 4 Islamic Banking Statistics Years Period 2010-2014................................. 11
Table 1. 5 Category of Islamic Bank’s Asset 2014.. 12

Table 2. 1The difference between Conventional Bank and Islamic Bank.................. 40
Table 2. 2 The difference between interest and loss/profit sharing 40
Table 2. 3 Category of Banks based on Equity Value 56
Table 2. 4 Previous Researches.. 58

Table 3. 1Operational Definition of Variables... 95
Table 3. 2 The Criteria of Sample.. 97
Table 3. 3 Sample of Research... 98

Table 4. 1 Statistics of Islamic Banking Efficiency in Indonesia 110
Table 4. 2 Descriptive Statistics Funding 112
Table 4. 3 Descriptive Statistics Financing.. 115
Table 4. 4 Normality Test One-Sample Kolmogorov-Smirnov Test........................ 119
Table 4. 5 Normality Test One-Sample Kolmogorov-Smirnov Test........................ 120
Table 4. 6 Multicollinearity Test Collinearity Statistics 125
Table 4. 7 Multicollinearity Test Collinearity Statistics 126
Table 4. 8 Multicollinearity Test Coefficient Correlation 109
Table 4. 9 Multicollinearity Test Coefficient Correlations...................................... 110
Table 4. 10Criteria of Durbin-Watson Test 113
Table 4. 11 Autocorrelation Test Durbin Watson.. 114

Table 4. 12 Autocorrelation Test Durbin Watson 114
Table 4. 13 Determination Coefficient R^2 116
Table 4. 14 Determination Coefficient R^2 117
Table 4. 15 F Statistical Test Anova 119
Table 4. 16 F Statistical Test Anova 119
Table 4. 17 T Statistical Test 121
Table 4. 18 T Statistical Test 122

LIST OF FIGURES

Figure 2. 1First Model 68

Figure 2. 2 Second Model 69

Figure 4. 1 Total Funding and Funding Growth 107

Figure 4. 2 Total Financing and Financing Growth 108

Figure 4. 3 Efficient and Inefficient Islamic Bank 108

Figure 4. 4 Normality Test Histogram 121

Figure 4. 5 Normality Test Histogram 122

Figure 4. 6 Normality Test P-Plot 123

Figure 4. 7 Normality Test P-Plot 124

Figure 4. 8Heteroscedasticity test Scatterplot 111

Figure 4. 9 Heteroscedasticity test Scatterplot 112

LIST OF APPENDIX

Appendix 1 Raw Data 145
Appendix 2 Efficiency VRS DEA 146
Appendix 3 SPSS Output 147

CHAPTER I

INTRODUCTION

1.1 Background

Sharia Banking is all matters concerning Sharia Banks (also referred to as Islamic Bank) and the Sharia (Islamic) Business Unit, including institution, business operation, means and process in the implementation of its business operation. While Islamic Banks are banks that operate their business activities based on Sharia principles. Sharia principles are Islamic legal principles in banking activities based *fatwa* (legal decision) issued by an institution that has the authority in the determination of *fatwa* in the field of sharia (UU No 21 of 2008).

The development of Islamic Banking in Indonesia is increasing every year. It is consistent to the purpose of the Indonesian national development to achieve a just and welfare society based on economic democracy, and economics system based on the value of justice, mutuality, equality, and benefit according to the principles of sharia. The banking system based onIslamic appear as the dynamic to the development of Conventional Banking. As cited in UU No. 7 of 1992, Indonesia started to implement dual banking system and has triggered the emergence of Islamic bank afterwards. Based on the initiative of the Indonesian Council of Ulamas (also refered to as Majelis Ulama Indonesia or MUI) and under the auspices of the government of Indonesia, therefore On May 1992 Bank Muamalat Indonesia (also referred to as BMI) was established. Its establishment was also supported by Muslim scholars and business man, as well as public.

The first idea of establishment initiated on MUI workshop entitled “Problems of Bank Interest” held on August of 1990 in Cisarua, Bogor. Workshop participants agreed to assign the Economic Development Commitee to build a bank which activities are based on Islamic set of guidlines. This decision was confirmed in the General Assembly of MUI in Jakarta, August 1990. Finally, BMI was the first private-owned Islamic Bank operating on the principle of Islamic banking and became a pioneer for the other Islamic Banks as known nowdays. At that time, despite Indonesia has no strong legal foundation to regulate Islamic Banking. However it became the leading factor for the existence of next Islamic Banks in Indonesia, instead of become an restriction toward the development of Islamic Bank.

BMI presence not only to position as the first purely Islamic Bank, but also equipped with the largest real time on line network in Indonesia. It is the only Islamic Bank of Indonesia which has opened branches abroad, namely Bank Muamalat Malaysia which was established in Kuala Lumpur on 1999. According to Islamic Banking Statistics of Indonesian on 2015, Nowdays BMI already has 85 branch offices, 261 syariah service unit, and 103 cash offices which spread over 33 provinces. Unfortunately, their number are still less than the number of government-owned Islamic Bank namely Bank syariah Mandiri which was established on October of 1999 and already has 187 branch offices, 510 syariah service unit, and also 65 cash offices overall.

UU No. 7 of 1992 then replaced by UU No. 10 of 1998 which is regulating the Islamic Banking clearly. Afterwards, this new regulation strengthen the position of Islamic Bank legally in Indonesia. It also stated that Conventional bank is officially allowed to establish Islamic Business Unit of Conventional Bank (Unit Usaha Syariah). Since then Conventional Banks are starting to form their own Islamic Business Unit. The considerations about the changes of UU was in purpose to anticipate the challenge of financial system which is getting more advance and complex in this globalization era. Therefore, the adoption of Islamic Banking in financial system of Indonesia is not only to accomodate the necessity of Moeslim but also considering the benefits of Islamic Banking in development of national economics system.

It is quite interesting to observe the development of Islamic Banking in Indonesia. As cited above, the number of Islamic Banks is increasing every year and has grown rapidly. The huge amount of population of Indonesian that reach almost 200 million people and the majority are moeslim, definetly becoming a big opportunity to the development of Islamic Bank. Also the existence of Islamic Banks are not created only for Moeslim but also opened for non Moeslim. This means that They give the opportunity for all customers and do not differ the customers. Up to now the Islamic Banking was still dominated 98 % by BUS and UUS while the rest is Islamic rural bank. The share of Islamic banking is 4,9 % ofall total asset of Indonesian Banking (Conventional banking is dominated with share 95 %).

According to Islamic Banking statistics of Indonesian taken from Financial Service Authority database, the number of Islamic Commercial Banks have been increased from 1997 up to 2015. It started from an Islamic bank has become into 12 Islamic Banks nowdays. There is no big change of their number in 1997 until 2009. But in 2010 their number increased almost twice, regarding UU No 21 of 2008 concerning sharia (Islamic) banking in Act No 7 of 1992 Concerning Banking as amended by Act Number 10 of 1998 is not described specifically yet therefore need to be regulated in a specific Act.

As cited above, Islamic Banking still have a few market power almost 5% from total asset of Conventional Banking in spite of their rapid growth. The number of total asset on June 2015 reach Rp 272,389 billion or has market share 4,9% from the total asset of Commercial Banking which reach Rp 5.933.195 billion. Total fund from third parties which collected reach Rp 215.339 billion, while total financing reach Rp 203.894 billion or grow 11,84 % every year. According to Indonesian Banking booklet of 2015 Despite the rapid growth of Islamic banking, the economic condition of Indonesia that is not good as the previous year has caused a little uncertainty in doing business that affected the performance and growth of Islamic Banking, cause the Islamic Banking industry is real sector driven where the decrease in real sector performance will directly affect the performance and growth of Islamic Banking. Therefore an apprehensive about the bank failure come up regarding they are the new comer in banking industry and still have a few market power. To anticipate the bank failure, learning from the previous global financial crisis is the right choice.

Table 1. 1Islamic Banking Network Years Period 1997 – 2015

Indicator	1997	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Islamic Commercial Bank														
Number of banks	1	2	3	3	3	3	5	6	11	11	11	11	12	12
Number of offices	-	-	-	-	-	-	-	711	1.215	1.401	1.745	1.998	2.151	2.121
Islamic Business Unit														
Number of Conventional Banks that have Islamic Business Unit	-	8	15	19	20	25	27	25	23	24	24	23	22	22
Number of Officess	-	-	-	-	-	-	-	287	262	336	517	590	320	327
Islamic Rural Bank														
Number of Banks	76	84	88	92	105	114	131	138	150	155	158	163	163	161
Number of Offices	-	-	-	-	-	-	-	225	286	364	401	402	439	433
TOTAL OFFICES	-	-	-	-	-	-	-	1.223	1.763	2.101	2.663	2.990	2.910	2.881

Source: Islamic Banking Statistics taken from Financial Service Authority database (Data processed)

Table 1. 2Islamic Commercial Bank and Islamic Business Unit Condensed Balance Sheet Years Period 1997 – 2015

Indicator	1997	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Asset	-	7.945	15.210	20.880	28.722	36.537	49.555	66.090	97.519	145.467	195.018	242.276	272.343	272.389
Depositors Funds	-	5.725	11.718	15.584	20.672	28.011	36.852	52.271	76.036	115.415	147.512	183.534	217.858	215.339
Financing	-	5.561	11.324	15.270	20.445	27.944	38.198	46.886	68.181	102.655	147.505	184.122	199.330	203.894

Source: Islamic Banking Statistics taken from Financial Service Authority database (Data processed)

A large number of developed, developing and in transition countries have experienced severe dramatic banking crises during the eighties and nineties and recently the 2007 to 2008 global financial crisis. Indonesia is one of those countries which was affected by the crisis, and need to suffer from the failure through some changes of policies. The global economic crisis comes from an aggressive risk-taking behavior giving a very important lesson learned for the regulator in securing regulation aspects. Enforcing regulation basically is intended to improve market structure to become stronger, efficient and more transparent, to benefit sustainable economy (Indonesian Banking Booklet 2015).The interest in the bank failure is caused by the bankruptcy substantial costs. Actually, the consequences of a bank failure are bringing the huge impact; financial losses for the fund suppliers including (shareholders, depositors, and insurers), loss of competitiveness of the banking industry and a destabilization of the financial system (Louati et al 2015).

Table 1. 3 The Micro Policy of Indonesian Banking Years Period 1997 – 2010

Years	Consolidation Policy
1997	1. Liquidation of 23 Banks 2. Recapitalize of Banks 3. Merger of 4 governement-owned banks become bank mandiri
2003	Privatisation of bailout-banking under the scheme of Indonesian Banking Restructuring Agency (IBRA)
2004	Making Indonesian Architectur Banking (API)
2004-2010	A set of merger and banking consolidation which conducted to fullfill Single Presence Policy and minimum adequacy requirement.

Source: Bulletin of Economy, Monetary, and Banking, October 2011

Louati (2015) also believe that the major cause of bank failure actually is the excess risk. It is the result of inefficient management and control of the bank lending activity. The asymmetry information is the cause of two issues that can affect the level of the credit risk. The first is an ex-ante problem called adverse selection which occurs before the financial transaction takes place. Adverse selection is when the lender is subject to risk from the borrower because of the information he keeps for his own interest. The second is an ex-post problem and also known as moral hazard. This type of problem arises after the granting of the credit. Such problem arises after the credit is granted as a result of the lender's failure to observe the borrower's actions (shares) so as to ensure the proper use of the distributed funds, which, therefore, affects the probability of repayment. Obviously, the level of the information asymmetry, of the adverse selection and of the moral hazard depends on the quantity and the quality of the information flow circulating between the lender and the borrower. This increase of the banking problems on a large scale has stimulated the interest of the economists and regulators about the stability of the financial system. Supervisors are indeed led to make room for growing internal controls and strengthen their prudential information. This change is due to the fact that an appropriate supervision of institutions is a precondition for the understanding of their risks.

Following the same path of the previous studies which were conducted by Mastura et al (2014) and Louati et al (2015), risk taking behavior could be identified through the changes of funding and financing, While their changes could be examined by some factors such as capital adequacy, Efficiency, size of banks, liquidity, equity and fee based income. Mastura believe that Capital adequacy plays an important role in determining banking activities. A bank must hold a minimum level of capital to ensure sufficient funds to buffer against unexpected losses or adverse shocks. While Louati followed with addition by emphasize the concept of banking competitiveness and its impact on the relationship between the capital requirement and funding and lending banking behavior. Therefore, the relation between the variables of this study are explained below.

Table 1. 4 Islamic Banking Statistics Years Period 2010-2014

Years	Funding	Financing	CAR	Efficiency VRS DEA	Asset	Equity	FDR	Fee based income
2010	76.036	68.181	16,25 %	0,957	97.519	8.862	89,67 %	1252
2011	115.415	102.655	16,63 %	0,976	145.467	10.614	88,94 %	262
2012	147.512	147.655	14,13 %	0,980	195.018	12.282	100 %	3.071
2013	183.534	184.122	14,42 %	0,953	242.276	17.541	100,32 %	5.736
2014	217.858	199.330	15,74 %	0,910	272.343	19.728	91,50 %	7.715

Source: Islamic Banking Statistics taken from Financial Service Authority database (Data Processed)

Table 1. 5 Category of Islamic Bank's Asset 2014

No	Banks	Asset (in million rupiahs)	Category
1	Bank Mu'amalat Indonesia	62.413.310	Large
2	Bank Victoria Syariah	1.439.983	Medium
3	Bank BRI Syariah	20.343.249	Large
4	B.P.D. Jawa Barat Banten Syariah	6.090.945	Medium
5	Bank BNI Syariah	19.492.112	Large
6	Bank Syariah Mandiri	66.942.422	Large
7	Bank Syariah Mega Indonesia	7.042.486	Medium
8	Bank Panin Syariah	6.207.678	Medium
9	Bank Syariah Bukopin	264.504	Small
10	BCA Syariah	2.994.449	Medium
11	Maybank Syariah Indonesia	2.449.723	Medium

Source: Website of each bank

First, the role of capital adequacy. According to Mastura et al (2014) Capital generally plays a crucial role in their long-term financing and solvency position and therefore in their public credibility. In the event of a crisis, the lower leverage ratio is, the lower the probability that a bank will fail to payback its debts. This fact tends to justify the existence of capital adequacy requirement in order to avoid bankruptcies and their negative externalities on the financial system. Maintaining sufficient capital is very important to keep the stability of bank itself and to support market conditions. Through his study, the conclusion is bank capital requirements have an impact on the funding and financing behaviors of the 52 Islamic banks in the sample. There is a strong positive relationship between bank capital to funding and financing growth for Islamic Banks. While Louati (2015) using a sample of 47 Islamic banks found that capital regulatory requirements have a significant impact only on the financing behavior of the

Islamic banks. However, the funding change for the Islamic banks is no longer affected by the level of the capital adequacy. Gosh (2014) using a sample of 46 Islamic banks found different result there is an uneven impact of regulatory pressure and market discipline on banks attitude toward risk and capital. In Indonesia itself the Capital Adequacy Ratio (CAR) of Islamics Banks were increasing from 2010 up to 2011, then decreasing from 2011 up to 2012, afterwards increasing significantly up to 2014 as we can see in the table above. They are respectively (in precentage) 16,25 %, 16,63%; 14,13%; 14,42%; and 15,74 %. Therefore, the number of funding and financing were also increasing every year. The changes of funding respectively are (in million rupiahs) 76.036, 115.415; 147.512; 183.534; and 217,858. While the changes of financing are 68.181, 102.655; 147.655; 184.122; and 199.330. Thus, it can concluded that the CAR has an implication to the changes of Funding and Financing of Islamic Banks in Indonesia.

Second, the role of banking competitiveness through Data Envelopment Analysis efficiency intermediary approach. In the literature, there are two opposing theories regarding the impact of competitiveness on banking behavior. The first shows that a competitive market may increase bank's risk-taking behavior in order to maintain their previous levels of profit (Allen & Gale, 2004; ellman, Mudock & Stiglitz, 2000). This risky behavior can be noticed either through the rise of the credit risk in the loan portfolio or through the fall of the capital level "buffer" or both simultaneously. These risky policies can lead to an increased level of non-performing loans and subsequently to a great probability of bank failure. However, the second theory postulates that a restricted competitiveness should encourage banks to protect their veryhigh “franchise values” by pursuing security policies that contribute to the stability of the whole banking system. Therefore, according to the paradigm of the “franchise value”, banks limit their risk when they have pensions, in example when they have market power. This theory was theoretically and empirically supported in the banking literature. Louati (2015) found that banking competitiveness of the Islamic banks has no significant effect on the relationship between the capitalization level and the banking behavior. competitiveness has a significant effect only on the credit variation. Weill (2011) also found that Islamic Banks do not have market power. Arris (2010) found that Islamic Banks are less competitive. Based on the concept of efficiency and competitiveness, that the highest score of efficiency, the highest level of bank competitveness. In Indonesia itself the efficiency value of Islamic Banking is high, which means the banking industry is competitive enough. Therefore the mean value of efficiency respectively from 2012 until 2014 0,957 ;.0,976 ; 0,980 ; 0,953 ; and 0,910. Therefore, the number of funding and financing were increasing every year. The changes of funding respectively are (in million rupiahs) 76.036, 115.415; 147.512; 183.534; and 217,858. While the changes of financing are 68.181, 102.655; 147.655; 184.122; and 199.330. Thus, it can be concluded that the efficiency has an implication to the changes of Funding and Financing of Islamic Banks in Indonesia.

Third, therole of size of banks .Size of bank is proxied by the log of asset. Louati (2015) conclude that size of bank has significantly negative impact to the funding, but has a positive impact to the financing. It is because the funding of Islamic Bank is not based on asset, while the positive impact to the financing confirms the result of Cihak and Hesse (2010) who expect the major Islamic banks to be more riskier and less stable. This can also be explained by the hypothesis of “too big too fail” according to which highly capitalized large Islamic Banks can engage in an excessive risk-taking behavior. Mastura (2014) conclude a significant negative effect of size (asset) to the both of funding and financing. The negative and significant coefficient on bank size on change of funding can be interpreted as larger banks holding a relatively small share of their assets in the form of financing. They may attract a relatively larger share of non-deposit or wholesale funding as their main source of short-term funding. The highly capitalized Islamic Banks consistently support the theory that, as they grow larger, their assets become more diversified. This is consistent with the fact that Islamic Banks provide a variety of Islamic financing products such as Murabahah and Bai Bithamin Ajil. The negative and significant coefficient for the Size variable, proxied by the log of assets, is confirmed by Peek and Rosengren (1995), Schmitz (2007) and Kunt and Huizinga (2011). They conclude that deposit and loan growth are slower for larger banks. While in Indonesia as we can see on the table above, Islamic Bank’s size are divided into three different categories. The large size is if the number of asset more than 10 billion rupiahs, medium size is 1 up to 10 billion rupiahs, and small size is less than 1 billion rupiahs. It indicates that the implication of bank’s size to the changes of funding and financing are different depend on the number of asset. Based on the number of asset in general as the determinant of bank's size were increasing significantly from 2010 up to 2014. They are respectively (in million rupiahs) 97.519, 145.467; 195.018; 242.276; and 272.343. Their increasing were significant to the changes of funding and financing. The changes of funding respectively are (in million rupiahs) 76.036, 115.415; 147.512; 183.534; and 217,858. While the changes of financing are 68.181, 102.655; 147.655; 184.122; and 199.330. Thus, from the data it can concluded that the size of banks (asset) has an implication to the changes of Funding and Financing of Islamic Banks in Indonesia.

Fourth, the role of equity. Louati (2015) show the significat positive impact of equity to the both of funding and financing. . The bank's financing react in the same manner as bank equity, as well as for the funding. While Mastura (2014) show the negative impact of equity to the both funding and financing. While in Indonesia as we can see on the table above, the number of equity were increasing significantly from 2010 up to 2014. They are respectively (in million rupiahs) 8.862, 10,614; 12.282; 17.541; and 19.728. Their increasing were significant to the changes of funding and financing. The changes of funding respectively are (in million rupiahs) 76.036, 115.415; 147.512; 183.534; and 217,858. While the changes of financing are 68.181, 102.655; 147.655; 184.122; and 199.330. Thus, it can concluded that equity has an implication to the changes of Funding and Financing of Islamic Banks in Indonesia.

Fifth, the role of liquidity. Loauati (2015) show the significant negative impact of liquidity to the funding, and positive impact to the financing. Mastura (2014) conclude the impact of liquidity is positive to financing, while liquidity has no impact to the funding. He believes that bank behavior is driven by the level of capital and not by the bank's liquidity position. Therefore, it is expected to have a negative impact on bank funding and a positive impact on financing growth. The negative impact can also be explained by the fact that banks will favor using liquid assets over their liabilities (funding) in order to meet capital requirements. While in Indonesia as we can see on the table above, the liquidity ratio were decreasing from 2010 up to 2011 then increasing up to 2013, then back to decreasing up to 2014. They are respectively (in precentage) 89,67%; 88,94%; 100%; 100,32% and 91,50%.. They have an implication to the changes of funding and financing which increasing each year. The changes of funding respectively are (in million rupiahs) 76.036, 115.415; 147.512; 183.534; and 217,858. While the changes of financing are 68.181, 102.655; 147.655; 184.122; and 199.330. Thus, it can be concluded that the liquidity ratio has an implication to the changes of Funding and Financing of Islamic Banks in Indonesia.

Sixth, the role of fee based income.Mastura (2014) conclude fee based income which is represented by the ratio of other operating income to total operating income. His study shows that changes of funding positively affected by the proportion of bank earnings. A significant, positive impact ofFee income on the growth of funding can be explained by bank stability. Banks with positive funding growth are likely less credit constrained and are, thus, in a better position to explore other off-balance sheet activities, compared with credit constrained banks, which may be limited in pursuing other operating income. While in Indonesia as we can see on the table above, the number of fee income were decreasing from 2010 up to 2011, but immadiately increasing up to 2014. They are respectively (in million rupiahs) 1.252, 262, 3.071, 5.736, 7.715. Their increasing were significant to the changes of funding and financing which increasing each year. The changes of funding respectively are (in million rupiahs) 76.036, 115.415; 147.512; 183.534; and 217,858. While the changes of financing are 68.181, 102.655; 147.655; 184.122; and 199.330. Thus, it can be concluded that fee based income has an implication to the changes of Funding and Financing of Islamic Banks in Indonesia.

In this context, the literature on this topic in the Islamic banking sector is still scarce. There are still lack of information to support this study. But realizing the study of the capital requirements of Islamic banks is relevant due to the principle of risk and profit sharing between the bank and customer that couldin turn reduce the overall risk incurred by the bank (Pellegrina Dalla,2007).

The Islamic banking system, mainly the investment loss and profit sharing, foster the investor's participation in equity, which promotes the assiduity in the investment management and proper monitoring. Furthermore, the other Islamic financial mechanisms (such as Murabahah, Ijarah and Istishna) require the involvement of investors in the real economy; as a result, financial transactions are fully backed by real assets. This feature enables Islamic banks to have a clearer view on the allocation of funds and reduce their exposure to speculative behavior (Khediri, Charfeddine & Ben Youssef, 2015). Siddiqui (2006) argues that equity-based Islamic contracts will reduce adverse selection and moral hazard problems, which thereafter, downplays the credit risk of these Islamic financial institutions. Actually, Islamic finance requires information symmetry and transparency in their transactions since Islam prohibits excessive uncertainty (gharar). Moreover, gambling (maysir) is prohibited, which means that excessive risk taking is not allowed. Finally, Cihak and Hesse (2010) argue that more difficult access to liquidity for Islamic banks requires that they should be more selective so that they will not incur a greater risk of moral hazard.

This study is to apply the impact of CAR, Efficiency, Size, Equity, Liquidity and Fee based income to the behavior of funding and financing. Most of the previous studies examined the effect of information asymmetry on the banking risk and operations in general. Since the CAR, Efficiency, size, equity. Liquidity and fee based income bring great pressure on the choice of the banking portfolio. Based on the data and phenomenome above, the writer will conduct a research entitled, **"The Impact of Capital Adequacy, Efficiency, Size, Equity, Liquidity and Fee Based Income to the Behavior of Funding and Financing of Islamic Banks in Indonesia "**.

1.2 Problem Identification

During theeighties and nineties and recently the 2007/2008 global financial crisis, many financial institutions especially in banking sectors are threatened to be collapsed. The high probability of bank failure is caused by the bankruptcy substantial costs. Actually, the consequences of a bank failure are bringing the huge impact, financial losses for the fund suppliers including (shareholders, depositors, and insurers), loss of competitiveness of the banking industry and a destabilization of the financial system as a whole if several individual failures escalate into a banking crisis through contagion mechanisms. The resolution of this type of failure implies a waste of resources, which are particularly scarce in the emerging economies. And finally cause economic activity to slow down.

The major cause of bank failure is the excess risk. It is the result of inefficient management and control of the bank lending activity. In this context, banks are risk taking. This risky behavior can be noticed either through the rise of the credit risk in the loan portfolio or through the fall of the capital level “buffer” or both simultaneously. These risky policies can lead to an increased level of non-performing loans and subsequently to a great probability of bank failure.

Capital generally accounts for a small percentage of the financial resources of banking institutions, but it plays a crucial role in their long-term financing and solvency position and therefore in their public credibility. In the event of a crisis, the lower leverage ratio is, the lower the probability that a bank will fail to payback its debts. This fact tends to justify the existence of capital adequacy requirement in order to avoid bankruptcies and their negative externalities on the financial system. Maintaining sufficient capital is very important to keep the stability of bank itself and to support market conditions.

This study is also to apply the concept of level of competitiveness through efficiency value and their impact to the funding and financing behavior of Islamic bank in Indonesia. According to Louati et al (2015) it cited more competition in banking industry necessarily result in a higher probability of banking failures, because it may increase risk-taking behavior of Banks. But another theory wich empirically supported in banking literature stated that Banks are going to limit their risk when they have high competition.

Since there is a lack of research which examine about the role of banking competitiveness through efficiency values and behavior of funding and financing, Whereas competitiveness condition bring great pressure on the choice of the banking portfolio. So the researcher wish to be able to contribute to the literature by emphasize the role of competitiveness through efficiency to the banking behavior in Indonesia.

Based on the problem which is explained before, this writer try to examine the risk taking behavior of Islamic Bank in Indonesia through funding and financing changes. How do the funding and financing change caused by the independent variables. Those are the capital adequacy and banking competitiveness through efficiency value, size ,equity, liquidity and fee based income.

The research approach the questions of capital adequacy, efficiency, size, equity, liquidity, and fee based income as mentioned below.

1. How does the implication of capital adequacy to funding's behavior of Islamic banks in Indonesia?
2. How does the implication of efficiency to funding's behavior of Islamic banks in Indonesia?
3. How does the implication of size of bank to funding's behavior of Islamic banks in Indonesia?

4. How does the implication of equity to funding's behavior of Islamic banks in Indonesia?
5. How does the implication of liquidity to funding's behavior of Islamic banks in Indonesia?
6. How does the implication of fee based income to funding's behavior of Islamic banks in Indonesia?
7. How does the implication of capital adequacy to financing's behavior of Islamic banks in Indonesia?
8. How does the implication of efficiency tofinancing's behavior of Islamic banks in Indonesia?
9. How does the implication of size of bank (asset) to financing's behavior of Islamic banks in Indonesia?
10. How does the implication of equity to financing's behavior of Islamic banks in Indonesia?
11. How does the implication of liquidity to financing's behavior of Islamic banks in Indonesia?
12. How does the implication of fee based income to financing's behavior of Islamic banks in Indonesia?

1.3 Research Objective

The first purpose of this study is to analyze the behavior of banks in terms of portfolio choice which is risk-taking, when the regulator imposes a solvency standard on them. The main challenge of this approach is to provide the basics of an effective prudential regulation that keeps the bank failure risk below a given threshold, which is considered acceptable. Therefore, banks are thus treated as portfolio managers operating on incomplete markets and whose decisions are compelled by prudential regulations. In other word to identify how much capital a bank needs in order to be protected against the excessive risk.

The second purpose is to examine the performance of funding and financing of Islamic banks in relation to the efficiency value. In other word, to identify the role of competitive conditions through efficiency to the funding and financing behavior.

The third purpose is to identify and analyze how the funding and financing of Islamic Banks in Indonesia changes because being affected by the changes of size of banks, equity, liquidity and fee based income.

There are some objectives of this research in highlight:

1. To examine the implication of capital adequacy to funding's behavior of Islamic Banks in Indonesia .
2. To investigate the implication of banking competitiveness through efficiency to funding's behavior of Islamic Banks in Indonesia .
3. To examine the implication of size of bank to funding's behavior of Islamic banks in Indonesia.
4. To examine the implication of equity to funding's behavior of Islamic banks in Indonesia.
5. To examine the implication of liquidity to funding's behavior of Islamic banks in Indonesia.

6. To examine the implication of fee based income to funding's behavior of Islamic banks in Indonesia.
7. To examine the implication of capital adequacy to financing's behavior of Islamic Banks in Indonesia .
8. To investigate the implication of banking competitiveness through efficiency to financing's behavior of Islamic Banks in Indonesia .
9. To examine the implication of size of bank to financing's behavior of Islamic banks in Indonesia.
10. To examine the implication of equity to financing's behavior of Islamic banks in Indonesia.
11. To examine the implication of liquidity to financing's behavior of Islamic banks in Indonesia.
12. To examine the implication of fee based income to financing's behavior of Islamic banks in Indonesia.

In fact, it is tried to identify and investigate the relationship between the Capital adequacy, bank competitiveness through efficiency, size, equity, liquidity, and fee based income to funding and financing behavior.

This study is expected might to contribute some benefits to the related party.

1. Theoretical aspect

   The result of research is expected could be reference to the academics and related parties in financial science, particularly in banking industry to expand the knowledge about financial behavior, especially the behavior of funding and financing of Islamic Banks in Indonesia.

2. Practical aspect

The result of research is expected could bring the benfits or contribution for the related parties in banking industries to analyze the ongoing market situation and to know the phenomenon whch is happening in banking industries in Indonesia. For the Investor, this result could be substance in considering and source of information to make an investment decision on a bank. While for the Bank, the result of this study could be the substance to consider financing decision, and bring some ideas to determine the better strategy in managing bank.

For the academics, this research is expected to contribute to the development of financial science, reference for the next research, and gain the knowledge for the reader, for the writer as the implementation of the theories that has been learned from the college, and also in practical work.

1.4 Research Outline

In order to make easier in understanding this research, this study is divided into five sections systematically. The main topic is The implication of capital adequacy, banking competitiveness through efficiency, size, equity, liquidity, and fee based income to behavior of funding and financing of Islamic Banks in order to observe their risk-taking behavior. It is organized as follows:

CHAPTER I: INTRODUCTION

This section is made up by four parts: background, problem identification, research objective, and outline in writing this study. Background introduce the topic and related issues, such as the introduction of Banks in general, the development of Islamic Banking , the phenomena of global financial crisis and how the banks suffer on it, emphasize how important capital adequacy and banking competitiveness, size, equity, liquidity and fee based income to behavior of funding and financing of Islamics Banks in order to understand their behavior in risk-taking. In problem identification, deliverd some problem in question form related the topic, describe the case which still ambiguous and emphasize the topic is need to be dig deeper. And the objective is explaining the purpose of the research which questionable in statement form and mentioning the parties who get benefit from this research. The research outline show the systematics in writing or the hightlight of the content.

CHAPTER II: LITERATURE REVIEW

This section is made up by four parts: Literature review, previous researches, framework and hyphothesis. The literature review explaining the topic or content from academic references such as book, undergraduated thesis and published journals. It contains some theoretical and empirical background which become the basic theory in writing this research. It also analyzing the related previous researches and describing their results. The framework states the theoretical thought in form of research modelling. This framework then construct the hypothesis. Hypothesis is temporary assumption towards the problem which need to be observed more.

CHAPTER III: RESEARCH METHODOLOGY

This section is made up by five parts: discussing about data description in empiric study include research variable identification and operational variable definition, population and sample determination, the type and source of data, technique or methodology in choosing data and methodology in analyzing data. The methodological approach includes, in a first stage, an efficiency measuring of Islamic banks using Data Envelopment Analysis method. Next, present an empirical analysis that deals with the relationship between CAR, efficiency, size, equity, liquidity and fee based income to the behavior of funding and financing.

CHAPTER IV: EMPIRICAL RESULT AND INTERPRETATIONS

This section is made up by three parts: presents the estimation result and description of research's object, data analysis, and their interpretations by statistical variable description. This part is the main point of the research.

CHAPTER V: SUMMARY AND CONCLUSIONS

This final section is made up by three parts: conclusion, research limitation, and suggestion. The conclusion is summary of result after observation. Limitation is the weaknesses which found after data analysis and interpretation. Suggestion is an expectations or recommendations to the related parties of research.