

OPTIMIZING INDONESIAN SHARIA RURAL BANKS' PERFORMANCE: INSIGHTS FROM INTERNAL FACTORS

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Abstract: This study aims to analyze the impact of financing risk, efficiency, liquidity, and capital adequacy on the performance of Islamic Rural Banks (BPRS) in Indonesia. BPRS performance is measured using Return on Assets (ROA), while financing risk is proxied by Non-Performing Financing (NPF), efficiency by the Operating Expenses to Operating Income ratio (BOPO), liquidity by the Financing to Deposit Ratio (FDR), and capital adequacy by the Capital Adequacy Ratio (CAR). This research uses secondary data from the annual reports of BPRS during the 2019–2023 period, with a total of 760 unbalanced panel data observations. The data analysis technique employed is Structural Equation Modeling–Partial Least Squares (SEM-PLS). The results reveal that financing risk (NPF) and efficiency (BOPO) have a significant negative effect on BPRS performance. Meanwhile, liquidity (FDR) shows no significant effect on performance. Capital adequacy (CAR) has a significant but inverse effect on BPRS performance. These findings indicate that financing risk management and operational efficiency are critical determinants in improving the profitability of BPRS. Furthermore, more strategic capital management is needed to ensure its effectiveness in supporting bank performance.

Keywords: BPRS, financing risk, efficiency, liquidity, capital adequacy, bank performance

Abstrak: Penelitian ini bertujuan untuk menganalisis pengaruh risiko pembiayaan, efisiensi, likuiditas, dan kecukupan modal terhadap kinerja Bank Pembiayaan Rakyat Syariah (BPRS) di Indonesia. Kinerja BPRS diukur menggunakan Return on Assets (ROA), sementara risiko pembiayaan diprosikan oleh Non-Performing Financing (NPF), efisiensi oleh rasio Beban Operasional terhadap Pendapatan Operasional (BOPO), likuiditas oleh Financing to Deposit Ratio (FDR), dan kecukupan modal oleh Capital Adequacy Ratio (CAR). Penelitian ini menggunakan data sekunder dari laporan tahunan BPRS selama periode 2019–2023 dengan total observasi sebanyak 760 data panel tidak seimbang. Teknik analisis data yang digunakan adalah Structural Equation Modeling–Partial Least Squares (SEM-PLS). Hasil penelitian menunjukkan bahwa risiko pembiayaan (NPF) dan efisiensi (BOPO) memiliki pengaruh negatif signifikan terhadap kinerja BPRS. Sementara itu, likuiditas (FDR) tidak menunjukkan pengaruh signifikan terhadap kinerja. Kecukupan modal (CAR) memiliki pengaruh signifikan tetapi berlawanan arah dengan kinerja BPRS. Temuan ini mengindikasikan bahwa manajemen risiko pembiayaan dan efisiensi operasional merupakan determinan utama dalam meningkatkan profitabilitas BPRS. Selain itu, pengelolaan modal yang lebih strategis diperlukan untuk memastikan efektivitas dalam mendukung kinerja bank.

Kata Kunci: BPRS, risiko pembiayaan, efisiensi, likuiditas, kecukupan modal, kinerja bank.

1. INTRODUCTION

Rural banks began emerging as financial institutions serving rural communities in the 19th century as part of efforts to enhance financial inclusion and provide financing access to farmers and small communities often overlooked by large commercial banks (Aschhoff, 1982). The early concept of rural banking is often linked to the establishment of Raiffeisen Banks in the mid-19th century. Friedrich Wilhelm Raiffeisen, a German philanthropist, founded the first rural credit cooperative in 1864 (Kölbach, 2021). Over time, this rural banking model spread to various countries, including Indonesia.

In Indonesia, rural banks have become an essential component of the financial system, focusing on financial inclusion, microfinance, and rural economic empowerment. The concept of rural banks in Indonesia has its roots in traditional financial institutions such as Lumbung Desa (early 20th century) and Bank Desa (Tempo, 2019). These institutions were established to support the needs of farmers and local communities. The modernization of rural banking began with the establishment of Bank Rakyat Indonesia (BRI) in 1895 in Purwokerto, Central Java, by De Wolff van Westerrode. Initially, BRI focused on providing credit to farmers and small traders (Ningsih, 2023). In 1992, the Indonesian government formally introduced the concept of rural banks under the framework of Bank Perkreditan Rakyat (BPR), regulated by the Financial Services Authority (OJK) (Perbarindo, 2016). However, prior to the formal regulation of BPR in 1992 under the Banking Law of that year, the first Islamic rural bank (Bank Perkreditan Rakyat Syariah, BPRS) had already been established.

To date, the development of Islamic financial institutions in Indonesia continues to show positive trends, driven by increasing public awareness of Sharia principles in financial management (Setyowati et al., 2019). A key component in the Islamic financial ecosystem is the Bank Pembiayaan Rakyat Syariah (BPRS). As an Islamic financial institution focusing on local communities, BPRS plays a strategic role in expanding financial inclusion, particularly for populations underserved by Sharia Commercial Banks (BUS) or Sharia Business Units (UUS). However, compared to the growth of BUS and UUS, the progress of BPRS remains relatively slow. Data from the Financial Services Authority (OJK) indicates that the market share of BPRS remains below 1% of total Islamic banking assets, significantly lagging BUS and UUS (OJK, 2024). This situation suggests that while BPRS has substantial potential, its realization faces numerous challenges requiring attention.

One of the key advantages of Bank Pembiayaan Rakyat Syariah (BPRS) lies in its ability to reach rural communities and the micro, small, and medium enterprises (MSMEs) sector (Hendri et al., 2023). BPRS is specifically designed to meet the needs of groups often underserved by Sharia Commercial Banks (BUS) or other formal financial institutions (Kholifah et al., 2022). With a simpler operational model compared to other Islamic banks, BPRS can provide Sharia-based financial services tailored to local needs, including more flexible and accessible financing schemes (Addury, 2019). This flexible structure enables BPRS to adapt swiftly to regional economic dynamics, such as responding to fluctuations in the agribusiness sector or seasonal community needs.

Other advantages of Sharia Rural Banks (Bank Pembiayaan Rakyat Syariah, BPRS) is their dual function as *baitul maal* and *baitut tamwil*. As *baitul maal*, BPRS manages social funds such as *zakat*, *infak*, and *sadaqah* to distribute them to eligible recipients, thereby supporting the economic empowerment of impoverished communities. As *baitut tamwil*, BPRS provides Sharia-compliant financial services, including business financing and savings, aligned with Islamic principles (Yahya, 2014). This synergy of functions positions BPRS as a key driver of Sharia-based financial inclusion and a catalyst for sustainable economic development in regional areas.

However, over the past five years, the number of BPRS has steadily declined due to significant challenges in meeting increasingly stringent core capital requirements (Ramli & Djumena, 2021). The regulatory policy mandating higher minimum core capital aims to strengthen the stability of the Sharia banking industry. Nevertheless, this policy imposes a considerable burden on BPRS, especially entities operating in regions with limited economic capacity. Many BPRS struggle to attract additional capital from shareholders or investors due to their small-scale operations and low profitability levels. Moreover, intense competition with other financial institutions, both conventional and Islamic, has further constrained BPRS's ability to expand its market and increase revenue. Consequently, some BPRS have opted for mergers, status conversions, or even ceased operations altogether. This decline in the number of BPRS is concerning, as it results in reduced access to Sharia-compliant financial services for rural communities and MSME segments, which have traditionally been the primary targets of BPRS. Strategic efforts are therefore needed to support the sustainability of BPRS, including more inclusive policy support and the empowerment of internal resources within the banks.

This study explores the internal factors that determine the sustainability of BPRS. Performance is a key indicator that reflects an organization's ability to achieve its objectives and execute its functions effectively and efficiently (Seashore & Yuchtman, 1967). For BPRS, performance holds strategic significance not only for operational sustainability but also for its contribution to promoting financial inclusion and strengthening the economy, particularly in the micro and small sectors. In this study, the performance of BPRS is proxied by Return on Assets (ROA).

The internal factors driving BPRS performance include financing risk (Alfiana et al., 2023; Mulatsih et al., 2024), efficiency (Destiani et al., 2023; Hijriyani & Setiawan, 2017), liquidity (Destiani et al., 2023; Ifan, 2023), and capital adequacy (Azahra et al., 2021; Putri et al., 2023). These factors are critically examined to provide insights into how BPRS can enhance their performance and sustain their role as facilitators of Sharia-compliant financial inclusion.

2. LITERATURE REVIEW

2.1. Agency Theory

This research is grounded in agency theory as the primary framework for understanding the relationship between financing risk, efficiency, liquidity, capital adequacy, and the performance of Sharia Rural Banks (Bank Pembiayaan Rakyat Syariah, BPRS). Agency theory emphasizes the contractual relationship between the principal

(owner) and the agent (manager), where managers are tasked with managing resources to achieve organizational goals (Jensen & Meckling, 1976). In the context of BPRS, owners and management face agency risks arising from conflicting interests, particularly concerning financing management, operational efficiency, and risk control.

This theory is pertinent in analyzing how the management of financing risk (Non-Performing Financing, NPF), efficiency (Operating Expenses to Operating Income, BOPO), liquidity (Financing to Deposit Ratio, FDR), and capital adequacy (Capital Adequacy Ratio, CAR) influences bank performance, as measured through profitability and growth. By examining the impact of these variables through the lens of agency theory, this study seeks to uncover causal relationships that can inform policymaking to enhance BPRS performance.

2.2. Hypothesis Development

2.2.1. *The Effect of Financing Risk on BPRS Performance*

Financing risk is one of the primary challenges faced by BPRS (Sharia Rural Banks) in their operations. A high Non-Performing Financing (NPF) ratio reflects problematic financing, which can reduce the bank's ability to generate revenue (Hijriyani & Setiawan, 2017). When NPF increases, BPRS are required to allocate reserves for non-performing financing, which decreases net profit and reduces the available capital for business development. Ultimately, this adversely affects the bank's overall financial performance.

Research by Duho et al. (2020) highlighted the critical role of credit risk in improving profit efficiency. Similarly, studies by Mayi et al. (2022) demonstrated a strong relationship between credit risk and profitability, proxied by ROA. In the context of Islamic banking, research by Alfiana et al. (2023) and Mulatsih et al. (2024), indicated a negative relationship between NPF and profitability in Islamic banks. High NPF levels not only weaken financial performance but also erode customer trust in the bank's stability.

Moreover, an increase in NPF can disrupt BPRS liquidity since non-performing financing reduces cash inflows. Consequently, banks may face difficulties in meeting short-term obligations, further damaging their reputation with regulators and the public. Based on these considerations, the proposed hypothesis is:

H1: Financing risk (NPF) negatively affects the performance of BPRS.

2.2.2. *The Effect of Efficiency on BPRS Performance*

Operational efficiency is a key indicator of a BPRS's ability to manage operational costs relative to operational income. The Operational Costs to Operational Income (BOPO) ratio is the primary measure used to evaluate a bank's efficiency (Hijriyani & Setiawan, 2017). A high BOPO ratio indicates inefficiency in managing costs, ultimately reducing the bank's profitability. Operational efficiency involves managing human resources, technology, and other operational strategies to minimize unnecessary expenses.

Rakshit & Bardhan (2022) found that higher efficiency levels correlate with improved financial outcomes, as efficient banks can better manage costs and revenues, enhancing profitability. Similarly, Hijriyani & Setiawan (2017) demonstrated that efficiency, as

proxied by BOPO, has a significant negative relationship with profitability in Islamic banking and BPRS (Destiani et al., 2023). Banks that effectively manage operational efficiency tend to possess higher competitiveness because efficiency enables them to offer products with more competitive profit margins (Fang et al., 2019), attracting more customers and increasing revenue. Therefore, the proposed hypothesis is:

H2: Efficiency (BOPO) negatively affects the performance of BPRS.

2.2.3. The Effect of Liquidity on BPRS Performance

Liquidity is a crucial aspect of banking operations, including BPRS, as it reflects the bank's ability to meet its obligations to customers. In BPRS, liquidity is measured using the Financing to Deposit Ratio (FDR), which indicates the extent to which third-party funds (DPK) can be channeled into financing (Tsania et al., 2022).

An optimal FDR ratio demonstrates the efficiency of BPRS in managing funds and increasing financing income. However, an excessively high ratio may pose liquidity risks, as the bank might lack sufficient reserves to meet sudden needs, such as customer withdrawals (Latifah et al., 2021). Conversely, a very low FDR ratio indicates the bank's inability to effectively channel financing, potentially hampering revenue growth.

Previous studies, such as those by Ifan (2023), showed that liquidity, measured by FDR, significantly impacts bank profitability, including in BPRS (Destiani et al., 2023). Banks with a healthy FDR ratio tend to have greater financial stability and can utilize customer funds to generate profits. Based on these arguments, the proposed hypothesis is:

H3: Liquidity (FDR) positively affects the performance of BPRS.

2.2.4. The Effect of Capital Adequacy on BPRS Performance

Capital adequacy is an important indicator for assessing a bank's stability and ability to manage risk. In BPRS, capital adequacy is measured using the Capital Adequacy Ratio (CAR), which reflects the extent to which the bank's capital can cover credit, operational, and market risks (Asriyana et al., 2022).

A high CAR assures that the bank has sufficient capital to absorb potential losses, increasing customer and regulator confidence. Moreover, adequate capital allows BPRS to expand financing without compromising financial stability. Research by Burhanuddin & Marsoem (2024) indicated a positive relationship between CAR and profitability in Islamic banks, as sufficient capital supports operational flexibility and better risk management.

However, maintaining a high CAR also requires effective capital management strategies (Azahra et al., 2021; Putri et al., 2023). If available capital is not well-managed, profit potential can diminish. Therefore, BPRS must ensure a balance between maintaining adequate capital and optimizing its use to enhance performance. Based on these considerations, the proposed hypothesis is:

H4: Capital adequacy (CAR) positively affects the performance of BPRS.

3. RESEARCH METHOD

This study adopts a descriptive quantitative and associative approach. The descriptive quantitative approach aims to systematically describe the phenomena under investigation through the processing of numerical data (Sugiyono, 2018). The associative approach is utilized to analyze relationships between variables, encompassing both correlations and causal linkages, including financing risk, efficiency, liquidity, capital adequacy, and the performance of BPRS. This combination of descriptive analysis and relational testing provides a more comprehensive understanding of the examined phenomena.

The research relies on secondary data obtained from the annual reports of BPRS, sourced through the official websites of the respective banks or the Financial Services Authority (Otoritas Jasa Keuangan, OJK) at ojk.go.id. The data includes financial performance indicators, financing risk, capital adequacy, efficiency, and liquidity for the 2019–2023 period.

The population of this study consists of all BPRS operating in Indonesia during the 2019–2023 period. According to the Sharia Banking Statistics (Statistik Perbankan Syariah, SPS) published by OJK in December 2023, there were 173 registered BPRS (OJK, 2024). Sampling was conducted using a census method, encompassing the entire population. However, the available data only covered 152 BPRS, resulting in a total of 760 observations. This approach was chosen to enhance data representation, ensuring greater accuracy in statistical estimations (Sarwono, 2006).

This study uses five main variables, namely:

Table 1. Variables and Operational Definitions

Variable	Kode	Rumus	Sumber
Performance	ROA	$ROA = \frac{\text{Net Income}}{\text{Total assets}}$	(Destiani et al., 2023)
Financing Risk	NPF	$NPF = \frac{\text{Non – Performing Financing}}{\text{Total Financing}}$	(Alfiana et al., 2023; Mulatsih et al., 2024)
Efficiency	BOPO	$BOPO = \frac{\text{Operating Costs}}{\text{Operating income}}$	(Destiani et al., 2023; Hijriyani & Setiawan, 2017)
Liquidity	FDR	$FDR = \frac{\text{Total Financing}}{\text{Total Third – Party Funds}}$	(Ifan, 2023; Latifah et al., 2021)
Capital Adequacy	CAR	$CAR = \frac{\text{Equity Capital}}{\text{Risk – weighted Assets}}$	(Burhanuddin & Marsoem, 2024)

This study employs the SEM-PLS (Structural Equation Modeling–Partial Least Squares) approach, a variance-based analytical method. SEM-PLS was chosen for its capability to analyze causal relationships among variables in the research model, including moderating variables, with flexible data assumptions such as unbalanced panel data. Data

analysis was performed using WarpPLS software, which offers high efficiency in handling complex data. WarpPLS also supports non-linear relationship analysis, allowing this study to explore inter-variable relationships more comprehensively.

4. RESULT AND DISCUSSION

4.1. Descriptive Statistics

Descriptive statistics provide a general overview of the characteristics of the data used in this study, covering variables such as financing risk (NPF), capital adequacy (CAR), liquidity (FDR), operational efficiency (BOPO), and the performance of BPRS (ROA). The mean, minimum, maximum, standard deviation, and number of observations for each variable are detailed to offer initial insights into the data distribution.

Table 2. Descriptive Statistics

	NPF	CAR	FDR	BOPO	ROA
Mean	7.41	32.01	94.87	99.74	1.55
Minimum	-0.23	-105.51	0	-0.27	-158.52
Maximum	97.53	469	934.49	5525.21	125
Standard Deviation	9.39	29.00	46.27	209.76	10.22
Count	760	760	760	760	760

The average NPF (Non-Performing Financing) for BPRS was recorded at 7.41%, indicating that financing risk is relatively manageable. However, the NPF range is extensive, from -0.23% to 97.53%, with a standard deviation of 9.39%, reflecting significant differences in financing risk across BPRS. The CAR (Capital Adequacy Ratio) averaged 32.01%, generally exceeding the regulatory minimum threshold. Nonetheless, the minimum CAR value of -105.51% suggests that some BPRS may face severe solvency issues.

Liquidity, measured by the Financing to Deposit Ratio (FDR), averaged 94.87%, indicating that financing distribution closely aligns with the total third-party funds collected. However, the FDR range is substantial, spanning from 0% to 934.49%, suggesting that some BPRS experience extreme liquidity levels. Operational efficiency, proxied by the BOPO (Operating Expense to Operating Income Ratio), averaged 99.74%, approaching a break-even point. The large variation (standard deviation of 209.76%) highlights disparities in operational management across BPRS.

The performance of BPRS, represented by ROA (Return on Assets), had an average of 1.55%, indicating positive net profitability. However, ROA values ranged widely from -158.52% to 125%, with a standard deviation of 10.22%, reflecting the presence of BPRS with either extremely poor or exceptionally strong performance.

A total of 760 observations were recorded for all variables, ensuring the data encompasses diverse financial conditions of BPRS over the observation period. These statistics highlight the heterogeneity in financial conditions across BPRS, forming the basis for further analysis of inter-variable relationships.

4.2. Model Fit Evaluation

The evaluation of model fit is a critical step to ensure the validity and reliability of the research model.

Table 3. Model Fit Evaluation Results

Description	Cut-off	Result	Evaluation
Average path coefficient	$P < 0.05$	0.183 $P < 0.001$	Model Fit
Average R-squared (ARS)	$P < 0.05$	0.269 $P < 0,001$	Model Fit
Average adjusted R-squared (AARS)	$P < 0.05$	0.265 $P < 0,001$	Model Fit
Average block VIF (AVIF)	Accepted if ≤ 5 ; Ideal ≤ 3.3	1.220	Ideal
Average full collinearity VIF (AFVIF)	Accepted if ≤ 5 ; Ideal ≤ 3.3	1.140	Ideal
Tenenhaus GoF (GoF)	small ≥ 0.1 ; medium ≥ 0.25 ; large ≥ 0.36	0.519	Large
Sympson's paradox ratio (SPR)	Accepted if ≥ 0.7 ; Ideal = 1	0.750	Acceptable
R-squared contribution ratio (RSCR)	Accepted if ≥ 0.9 ; Ideal = 1	0.915	Acceptable
Statistical suppression ratio (SSR)	Accepted if ≥ 0.7	1,000	Acceptable
Nonlinear bivariate causality direction ratio (NLBCDR)	Accepted if ≥ 0.7	1.000	Acceptable

Based on the evaluation results, the Average Path Coefficient (APC), Average R-Squared (ARS), and Average Adjusted R-Squared (AARS) each exhibit significant values with p-values below 0.001, indicating that the model is well-fitted to the available data. Multicollinearity indicators, such as the Average Block Variance Inflation Factor (AVIF) and the Average Full Collinearity VIF (AFVIF), are recorded at 1.220 and 1.140, respectively, which fall within the ideal category (below 3.3).

In terms of overall model strength, the Tenenhaus Goodness of Fit (GoF) value is 0.519, signifying a large model fit. Additionally, other indicators, such as the Sympon's Paradox Ratio (SPR) at 0.750 and the R-Squared Contribution Ratio (RSCR) at 0.915, are within the acceptable range.

These findings demonstrate that the constructed model is not only valid but also capable of accurately capturing the relationships among the variables. All indicators support the conclusion that the research model is suitable for further hypothesis testing and analysis.

4.3. Empirical Research Model

The empirical research model aims to analyze the relationships between financing risk, efficiency, liquidity, and capital adequacy on the performance of Islamic Rural Banks (BPRS). The results of the path analysis provide insights into the strength, direction, and significance of the relationships among the variables in this study. Interpretations are made based on the path coefficient values and significance levels (p-values), considering the hypotheses proposed earlier.

Table 4. Results of Path Analysis

Path Analysis	Coefficient	P-Value	Result
Financing Risk → Performance	-0.228	<0.001	Significant
Efficiency → Performance	-0.395	<0.001	Significant
Liquidity → Performance	-0.025	0.241	Insignificant
Capita; Adequacy → Performance	-0.083	0.010	Significant but opposite direction

Based on the analysis results, financing risk has a significant negative effect on the performance of BPRS, with a coefficient of -0.228 (p-value < 0.001). This indicates that an increase in financing risk, as reflected by a high Non-Performing Financing (NPF) ratio, adversely impacts bank performance. Efficiency also shows a significant negative effect, with a coefficient of -0.395 (p-value < 0.001), emphasizing that operational inefficiency, such as a high Operating Expenses to Operating Income (BOPO) ratio, can significantly reduce BPRS performance.

Conversely, liquidity, as proxied by the Financing to Deposit Ratio (FDR), does not exhibit a significant effect on BPRS performance, with a p-value of 0.241. This suggests that liquidity fluctuations have not yet had a meaningful impact on BPRS performance. Capital adequacy shows a significant effect on performance (p-value = 0.010); however, the negative direction of the relationship (-0.083) contradicts theoretical expectations. This finding implies that an imbalance in increasing the Capital Adequacy Ratio (CAR) may burden bank operations, ultimately affecting performance negatively.

These findings underscore the importance of managing financing risk and operational efficiency as key factors in improving BPRS performance. At the same time, the roles of liquidity and capital adequacy require further investigation to better understand their implications.

4.4. Discussion

4.4.1. *The Influence of Financing Risk on BPRS Performance*

The findings indicate that financing risk (NPF) has a significant negative effect on BPRS performance, with a coefficient of -0.228 (p -value < 0.001). This result aligns with financial theory, which posits that high financing risk reflects a poor financing portfolio quality, leading to a decline in return on assets (ROA). Elevated NPF levels highlight borrowers' inability to fulfill obligations, ultimately increasing the provision for financing losses for BPRS. This underscores the critical importance of effective financing risk management to maintain stability and ensure sustainable BPRS performance. This study aligns with previous research, including Alfiana et al. (2023), Hijriyani & Setiawan (2017), and Mulatsih et al. (2024).

4.4.2. The Influence of Efficiency on BPRS Performance

Efficiency, measured by BOPO, has a significant negative effect on BPRS performance, with a coefficient of -0.395 (p -value < 0.001). High BOPO values indicate operational inefficiency, which can significantly reduce bank profitability. This finding supports the view that operational efficiency is a critical factor in enhancing bank profitability. Failure to control operational expenses relative to operating income undermines BPRS competitiveness in the market. Therefore, improving efficiency through resource optimization and streamlined operational processes should be prioritized. These findings are consistent with those of Destiani et al. (2023) and Hijriyani & Setiawan (2017).

4.4.3. The Influence of Liquidity on BPRS Performance

Liquidity, proxied by FDR, does not significantly affect BPRS performance, with a p -value of 0.241 . This result suggests that liquidity levels are not always a primary determinant of bank profitability in the BPRS context. A potential explanation is that variations in FDR may reflect differences in financing strategies among BPRS rather than actual liquidity conditions. This finding highlights the need for a more contextual approach to evaluating the relationship between liquidity and performance, particularly in Islamic banking, which operates under distinct principles compared to conventional banks.

4.4.4. The Influence of Capital Adequacy on BPRS Performance

Capital adequacy (CAR) significantly but negatively affects BPRS performance, with a coefficient of -0.083 (p -value = 0.010). While theoretically, higher CAR indicates stronger financial security, the results suggest that excessive capital increases without optimal productivity can burden bank operations. In the BPRS context, inefficient increases in CAR may stem from regulatory pressures to meet minimum capital standards, thereby limiting the bank's ability to productively allocate funds. These findings emphasize the importance of strategic capital management to ensure its positive contribution to bank performance.

5. CONCLUSION

This study aims to analyze the influence of financing risk, efficiency, liquidity, and capital adequacy on the performance of Islamic Rural Banks (BPRS) in Indonesia. The findings provide key insights into the factors affecting BPRS performance, measured through Return on Assets (ROA).

First, financing risk, as proxied by Non-Performing Financing (NPF), has a significant negative impact on BPRS performance. This finding highlights that high NPF, reflecting problematic financing quality, can hinder the profitability of BPRS. Second, efficiency, measured by the BOPO ratio, also exhibits a significant negative effect on BPRS performance. This underscores that operational inefficiencies, such as high operating expenses relative to income, are a primary factor contributing to low bank performance. Third, liquidity, proxied by the Financing to Deposit Ratio (FDR), does not significantly influence BPRS performance. This suggests that liquidity fluctuations are not yet a key determinant of profitability levels in BPRS. Finally, capital adequacy, represented by the Capital Adequacy Ratio (CAR), shows a significant but negative effect on BPRS performance. This indicates that an increase in capital, when not matched by optimal productivity, can strain bank operations and reduce profitability.

These findings highlight the critical importance of effective risk management and operational efficiency in improving BPRS performance, while also pointing to the need for a strategic approach to liquidity and capital management to maximize their contributions to bank profitability.

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